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The intelligent quarterly from the publishers of T

WHERE ARE THE MISSING BILLIONS?

Reported Q3 cat losses fail to match projections

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Estimating the loss

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Oceanic and Atmospheric Administration.

The intelligent quarterly from the publishers of *The Insurance Insider*

WEEKENDER

Once in these pages I likened a prolonged soft market to a house party that gets out of hand.

It starts off as a lot of fun, with everyone socialising and having a good time. The music gets turned up louder and louder and someone decides it would be amusing to fill the fruit punch with vodka.

The more experienced take this as their cue to call it a night.

Once they leave all hell breaks loose.

Some surprising new liaisons are cemented, some in full view of other guests and, notably, one in the guest bedroom under a pile of coats. Someone passes out in the basement.

Later, obnoxious gatecrashers arrive and a knife fight breaks out. A man is stabbed.

The neighbours call the police and the party ends with a raid.

Seemingly oblivious to the mayhem a couple have a screaming stand-up row in the front garden.

In the grey light of dawn the hapless host discovers that the living room carpet is covered with cigarette burns and red wine stains. Smashed ornaments and crockery are everywhere.

The hangovers are brutal and the contrition is long-lasting.

Some consequences are life-changing. The stab victim's scar is a permanent reminder of how things can go badly wrong.

Meanwhile, unnoticed by revellers and police alike, the guest who passed out has not and will never reawaken. He is dead from an unspecified overdose.

Everyone swears they are never going to drink again and a period of puritanical abstinence follows.

At least, that is how the moral story used to go.

This soft market is different. This time someone has put a new wonder drug into the cocktails. It's like rocket fuel and has kept the party going much, much longer. Miraculously, it seems to prevent both the formation of hangovers and the onset of fatigue.

The sun has come up and the rave is still on. People are dancing on the tables and chairs. Not a single person has crashed out, passed out or left for home.

There was worrying moment at 4am when the police came and banged on the door. But they were sent on their way with a combination of charm and guile. Nothing is going to stop this.

Neighbours who had complained of the noise were convinced to join the party and are exuberantly displaying the full convert's zeal. There had been some bickering but peacemakers stepped in and cooled it down just in time.

A pizza delivery has come and gone. Everyone has a full stomach and is happy. There are only smiles and an overall air of contentment reigns.

Even more curious, given the all-round excess, is an almost paradoxical sense of sobriety and rationality about the gathering. This drug makes everyone appear in control.

On the pages that follow Charlie Thomas wonders where the missing HIM billions are, but no one at this party appears to be bothered by this question. These guys are certain the numbers will either turn up and will be easily replaced, or it will transpire they have been overcooked and therefore get written down.

Either way, they think the end result is that we'll all be back on the dancefloor before long.

An online re-stocking of the liquor cabinet is on its way. The crowd is invincible. It looks like we could be in for a weekender.

Monday is a very long way away. What could possibly go wrong?

MARK GEOGHEGAN
Managing director, Insider Publishing

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AROUND THE WORLD

IQ's roundup of regional market developments

IRELAND

Ophelia losses

Despite relatively modest insured losses and a mercifully low casualty toll, ex-Hurricane Ophelia, which made landfall in Ireland on 16 October, was nonetheless a notable event.

Catastrophe data specialist Perils estimated insured losses at EUR60mn ($71.6mn) after Ophelia caused significant damage across Ireland, and lesser damage in Wales, Northern Ireland, north-western England and Scotland. Falling trees killed three people in Ireland during the storm.

Perils said the storm caused EUR49mn ($58.5mn) of damage in Ireland, with another EUR10mn ($12mn) of damage occurring in the UK.

Perils noted that Ophelia was a very rare European windstorm in that it resulted from a tropical cyclone travelling much further east across the North Atlantic than usual.

It is the largest hurricane ever recorded that far east in the North Atlantic Basin, having reached Category 3 on the Saffir-Simpson hurricane scale by 14 October, before becoming an "ex-hurricane" the following day.

IRAN

2-3% of quake losses covered

The magnitude 7.3 earthquake that struck near the Iran/Iraq border is reported to have killed around 500 people and injured thousands more in Iran's Kermanshah Province, near the temblor's epicentre.

The quake also killed 10 people in Sulaimaniyah, Iraq, and injured more than 400 more in the neighbouring country.

Kermanshah Province's vice governor, Mojtaba Nikkerdar, has put economic losses from the disaster at 26tn rials ($738mn).

Early loss figures for the 12 November quake indicate that between 2 and 3 percent of properties in the earthquake zone were insured, according to English-language Iranian business newspaper *The Financial Tribune*.

Iran's largest insurer, the state-owned Iran Insurance Company, is expected to pay out 300bn rials ($7.7mn) in claims, *The Financial Tribune* said.

The insurer has so far paid 1.3bn rials for 1,320 claims.

Alborz Insurance is reported to have insured 8,000 homes damaged in the earthquake.

US

California wildfire losses reach $3.5bn

Total disclosed losses from what are likely to be the costliest wildfires in Californian history reached $3.5bn as of 20 November.

The bulk of losses are concentrated among a relatively small number of personal lines insurers.

State Farm, Farmers, California State Auto Association (CSAA) and Allstate are the four largest primary writers in the Northern California homeowners' market.

Together the four insurers took a 48.8 percent share of the state's homeowners' multi-peril insurance market in 2016, according to AM Best.

Allstate has put out an initial wildfire loss estimate of $452mn, while it is understood that CSAA has a $950mn loss.

Elsewhere, AIG CFO Sid Sankaran disclosed on the company's third quarter earnings call that it would take approximately $500mn of losses from the wildfires.

Sankaran said the figure was "net of reinsurance and largely in our personal insurance business".

GERMANY

Xavier causes losses of $343mn

Property damage caused by Extratropical Cyclone Xavier is expected to cost EUR291mn ($343mn), according to an initial insured loss estimate from catastrophe data aggregator Perils.

The storm struck Hamburg on 5 October, killing seven people as it moved through Lower Saxony, Saxony-Anhalt and Brandenburg before reaching Berlin.

Perils said the timing of the storm meant that more trees were felled than if it had happened later in the year, as autumn leaves caught in the wind.

Georg Andrea, head of data management at Perils, noted that "a significant part of the damage was caused by falling trees which still had leaves on them".

The company said it would release an updated estimate on 5 January 2018, three months after the event.

MOORE STEPHENS

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100%
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Over 25%
of Lloyd's syndicates are using RuleBook

2,200
brokers access RuleBook platforms

10
deployed in over 10 countries

THE ULTIMATE INSURANCE BEAST

RuleBook is a market leading pricing, underwriting and distribution tool. Our latest generation, multi award-winning platform is now used by over 25% of Lloyd's syndicates, with clients across three continents. Trusted by some of the leading names in the market, RuleBook is helping our clients become more agile in pricing, giving better control of the underwriting process and allowing them to distribute products fast and wider than ever before.

Global market updates by class of business

Aviation

Underwriters in the airline market are reported to have secured 3 to 5 percent increases in lead premiums in the key fourth quarter renewals, after 15 years of downward pricing pressure.

London market sources canvassed by sister publication *The Insurance Insider* said in the aggregate the increase broadly tracked exposure growth in the market, with renewals roughly flat for leaders on a risk-adjusted basis.

However, composite premiums rose more strongly, with exposure-adjusted rates up by single digits as following markets closed the gap with leaders after a disciplined showing.

The tone from some underwriters remained downbeat, with rates well below technical levels, but other sources were hopeful that Q4 renewals could presage a turn in the market.

Cyber

Pool Re CEO Julian Enoizi said the UK terrorism reinsurer had sealed a "clear gap" in its cyber terrorism coverage as it outlined plans to provide cyber physical damage reinsurance.

The coverage extension, which takes effect on 1 April 2018, will protect against property damage and direct business interruption caused by terrorist hacks.

At the Pool Re launch event in London, Enoizi said the new coverage will be part of standard property policies purchased from Pool Re members.

Pool Re chief underwriting officer Steve Coates added that the retrocession market had agreed to include the coverage next year, on condition it did not extend to contingent business interruption caused by cyber terrorism. Pool Re chief underwriting officer Steve Coates added that the retrocession market had agreed to include the coverage next year, on condition it did not extend to contingent business interruption caused by cyber terrorism.

D&O

21st Century Fox has agreed to settle a shareholder derivative lawsuit arising from the sexual harassment scandal that enveloped the Fox News network last year.

Representatives from 21st Century Fox confirmed that the $90mn settlement would be funded by the company's directors' and officers' insurers.

The settlement provides that the individual defendants and the estate of the late chairman and CEO of Fox News Roger Ailes, who was ousted from Fox amid a sexual harassment scandal, will "cause their insurers to make a payment" of $90mn to the company.

Professional indemnity

Brit is withdrawing from the international professional indemnity (PI) market, according to sister publication *The Insurance Insider*.

It is understood that members of the carrier's UK and international PI team in London are in consultation with Brit over their roles.

The team is led by class underwriter Daniel Mitchell, who is supported by underwriters Patrick Ruffell, James Russell and Alannah Paul.

Jonathan Mudd, divisional director for professional lines, has ultimate oversight of the PI division, which includes North America, although Brit's North American PI business is unaffected by the decision.

Brit declined to comment.

Product recall

Global confectionery giant Mars is claiming for $50mn-$60mn on its product recall policy after it recalled thousands of chocolate products over fears of potential salmonella contamination.

It is understood that Allianz Global Corporate & Specialty (AGCS) leads the London-placed policy with a $25mn layer in excess of a $25mn retention.

It is further understood that Talbot leads the following excess layer on the Aon-brokered placement, with XL Catlin also on the stack.

In June, Mars issued a precautionary recall of Galaxy Milk bars and counters, Minstrels and Maltesers chocolates with best-before dates of 6 May 2018 and 13 May 2018 for sale in the UK and Ireland.

Crisis management

Liberty has confirmed it is withdrawing its crisis management offering in both the US and the UK "following a strategic review".

The crisis management product includes contaminated products insurance, product recall and kidnap and ransom.

In a circular to brokers, Liberty International Underwriters (LIU) said the decision was part of the ongoing integration of Ironshore and Liberty.

It is understood that the 11-strong LIU US team – which includes Jane McCarthy and transferred Liberty Specialty Markets (LSM) senior underwriter Julie Ross – and a team of four at LSM in London are all in consultation with Liberty over their future roles at the company.

Market intelligence on the QT

Career best

Followers of AJ Gallagher (AJG)'s Twitter account may have noticed that the racing driver son of International CEO Grahame "Chily" Chilton is something of a chip off the old block.

Commenting for the AJG news page on his IndyCar career best performance, Max Chilton noted: "The risk/reward in IndyCar is pretty large...which is why I'm calm, cool and collected on the track."

Chilton Jr, who recently came fourth in the 101st Indianapolis 500 in his Gallagher-sponsored Honda, is also currently ranked fifth in the FIA World Touring Car Championship.

In a sponsor-pleasing footnote he added: "Insurance is about risk and reward – making calculated decisions. That's motorsports."

Private view

Insider Quarterly notes that the cover of the autumn issue has graced the Lloyd's Galleries Twitter feed, albeit with added smut. Thankfully, however, it has evaded the ire of Lloyd's denizens, who have erupted at the Society's decision to move the Nelson Collection (artefacts, letters and silverware relating to the hero of the Battle of Trafalgar) to a new location.

Nelson has increasingly become a subject of controversy over his associations with the colonial slave trade. However, Lloyd's Galleries has focused instead on the perceived insult to the Admiral's memory.

"The Nelson Collection is now permanently by the bogs. Retweet if you are appalled" went one Tweet, while another blustered: "England expects that every man will do his duty. England does not expect every man to be charging his phone where the Nelson collection should be."


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WHERE ARE THE MISSING BILLIONS?

Reported Q3 cat losses fail to match projections

Charlie Thomas

This year is likely to be one of the costliest on record for the international (re)insurance industry, thanks largely to hurricanes Harvey, Irma and Maria (HIM).
But how much those hurricanes will end up costing the industry is a matter of contention. Modellers seem unable to agree, with estimates ranging from less than $100bn to more than $140bn. The early net numbers published so far by carriers meanwhile, adds up to less than $50bn.
And uncertainties abound around how much demand surge could inflate rebuilding costs, how much loss adjustment expenses will go up by, and how much of the loss will ultimately end up in the relatively opaque alternative capital markets.
There are therefore three main questions that need to be

and; thirdly, how much confidence can we have in the answers to the first two questions?

Estimating the loss
This year has arguably seen one of the busiest seasons for named storms. Some 17 named storms formed, 10 of which reached hurricane strength, and six of which became major hurricanes, according to the National Oceanic and Atmospheric Administration.
That means 2017 had the most named storms and hurricanes since 2005, when 28 named storms developed, 15 of which became hurricanes. It was also the first year since 2005 that hurricanes struck the continental US.
Insured loss ranges vary wildly between different parties. Data provider PCS currently estimates the total for Harvey at $15.9bn, Irma's total at $18bn and Maria at $21.9bn, meaning together

As the (re)insurance industry continues to count the cost of hurricanes Harvey, Irma and Maria, Charlie Thomas asks if the third quarter windstorm losses still look like a $100bn event

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But how much those hurricanes will end up costing the industry is a matter of contention. Modellers seem unable to agree, with estimates ranging from less than $100bn to more than $140bn. The early net numbers published so far by carriers, meanwhile, add up to less than $50bn, around $28bn of which relates to HIM and the Mexican quakes. (see table on page 13).

And uncertainties abound around how much demand surge could inflate rebuilding costs, how much loss adjustment expenses will go up

Market-wide loss estimates ($bn)

Company/Organisation	Harvey	Irma	Maria	Nate	Mexican quake	California wildfires	Total
AIR Worldwide	10	41	62.5	na	0.96	9.25	
California Dept of Insurance	na	na	na	na	na	9.4	
CoreLogic	21.7	24.75	na	1	na	na	
Karen Clark & Company	na	25	na	0.5	na	na	
Munich Re	25	na	na	na	na	na	
PCS	15.9	18	21.9	na	na	7.3	
RMS	21.5	41	22.5	0.5	1.2	7	
Midpoint:	**17.5**	**29.5**	**42.5**	**0.75**	**1.1**	**8.2**	**89.8**
Average:	**18.8**	**30**	**35.6**	**0.67**	**1.1**	**8.2**	**91.4**

Note: Estimates represent either midpoint of range given or total figures advised by companies

Source: *Insider Quarterly,* company announcements, as of 13 December by, and how much of the loss will ultimately end up in the relatively opaque alternative capital markets.

There are therefore three main questions that need to be answered: firstly, do we still believe hurricane-related insured losses will amount to more than $100bn; secondly, if yes, where in the (re)insurance food chain will the losses end up; and thirdly, how much confidence can we have in the answers to the first two questions?

Estimating the loss

This year has seen one of the busiest seasons for named storms. Some 17 named storms formed, 10 of which reached hurricane strength, and six of which became major hurricanes, according to the National Oceanic and Atmospheric Administration.

That means 2017 had the most named storms and hurricanes since 2005, when 28 named storms developed, 15 of which became hurricanes. It was also the first year since 2005 that hurricanes struck the continental US.

Insured loss ranges for the storms vary wildly between different parties. Data provider PCS currently estimates the total for Harvey at $15.9bn, Irma at $18bn and Maria at $21.9bn, meaning together the three events would cost just $55.8bn.

The Bermuda Monetary Authority, meanwhile, has claimed that carriers on the island will collect a $31.2bn net burden from the trio of storms, which it estimated would account for 30 percent of the global industry's losses. That would put the total at around $104bn.

AM Best, on the other hand, said its survey of rated carriers suggested a total of $90bn, while estimates from the two largest modelling firms, AIR Worldwide and RMS, range from as little as $75bn to more than $125bn.

The huge variance in estimates is in part driven by the different methodologies used by the various parties.

PCS, for example, generates its figures using data from confidential surveys of insurers, agents, adjusters, public officials and other sources, which it then analyses alongside trend factors to produce an estimate.

Loss numbers generated on this basis can deteriorate by at least 25 percent, and do not capture 100 percent of the US losses.

Meanwhile AIR and RMS, as the feature on page 18 explains in more detail, differ wildly in terms of the inputs for their models, including the assumptions they take on properties and their ability to withstand damage.

Puerto Rico and other problems

Nowhere is this more obvious than with the firms' estimates for Maria, which hit the Caribbean at the end of September. RMS estimated that insured losses would come in between $15bn and $30bn, while AIR surprised the market with a range of $40bn-$85bn, with $35bn-$75bn of that coming from Puerto Rico. It later revised its estimate downwards to $27bn-$48bn, with $25bn-$43bn for Puerto Rico.

The vast difference in the ranges is in part down to differing beliefs on the vulnerability of Puerto Rico's buildings. RMS believed Puerto Rico's bunker-style buildings would largely have been able to withstand the storm, while AIR assumed wind damage would have seriously hit the vulnerable upper storeys of the island's buildings.

AIR also believed "demand surge" was likely to hit repair and rebuild costs – suggesting as much as 27 percent of its uppermost estimate could come from that.

This confused situation from third party vendors, plus the lack of data coming out of the affected regions – particularly in Puerto Rico – has resulted in a very mixed bag of views.

Ian Beaton, CEO at Ark Underwriting, thinks a bill of more than $100bn still sounds possible, based on the assumptions published so far.

"Like all the other cats we won't know the true number for a while, but plus or minus $10bn, it's probably correct," he says, although we're likely to get closer to that level if we include losses from the Mexican quakes and Californian wildfires.

Between the estimates from AIR, RMS, PCS, AM Best and others, once you add in charges to the National Flood Insurance Program and the cat bond market, it feels like it gets towards $100bn, he added.

RK Harrison's head of claims Nick Coles, on the other hand, disagrees. Based on looking at his clients' books of business, Coles says it "looks unlikely that we'll reach $100bn from the HIM hurricanes alone".

"There are some really big losses out there, but it doesn't look as though there are enough of them, at this point, to get to that sort of number," he adds.

Another issue worth considering is that primary carriers were reportedly put under pressure by their reinsurance counterparts to come out with loss estimates more quickly than they wanted to.

"A number were uncomfortable about it at the time," says Coles. "What they didn't want to do was end up step-reserving, as it doesn't make the claim run particularly smoothly. It creates a level of angst in the claim which is unhelpful. Perhaps that's pushed some of the estimates to be over-egged and [resulted in] some higher reserves coming out."

How the losses shake out

Few commentators have been brave enough to try and estimate how much of the net loss will end up with primary insurers, reinsurers, retro providers and alternative capital, but broadly speaking, it seems most expect between 25 percent and a third could end up with alternative money – that market's first real test since it was born out of 2005's cluster of hurricanes.

AM Best was one of the few to try and put a number on the various groups. In a report released in November, it suggested that based on conversations with rated entities some $45bn of the losses from HIM and the Mexican quakes would sit with the primary market, another $20bn-$25bn with the reinsurance market, and a final $20bn-$25bn with alternative capital, mostly in the form of collateralised retrocession.

The high level of primary net loss might look surprising, but a number

Continued on page 12

of sources indicated that retentions had been increasing over the past decade, particularly in Puerto Rico.

As detailed on page 22, our own interrogation of the insurance-linked securities (ILS) and retro markets seems to mirror this outcome.

Hurricane risk is the ILS market's greatest area of exposure, but the HIM storms each presented such different challenges that they impacted ILS managers in a variety of ways. Retrocession specialists bore the brunt of the losses as aggregation claims mounted, while the cat bond market appears to have got away relatively lightly.

Off-the-record comments from the market suggest retro writers may have lost up to half of their money this year, although it's challenging to get confirmation, given that these players sit at the end of the value chain and may have difficulty establishing their losses at such an early stage.

Looking at the industry loss warranty (ILW) market, the Micrix index fell 12 percent after September, implying a $720mn loss from the $5bn-$7bn market, although when aggregate ILW triggers are added in this figure is likely to be higher.

Interestingly, this event also seems to suggest that retro strategies are far more exposed to a 1-in-10-year aggregate loss than a 1-in-100-year single hurricane.

Mitigating factors

Underlying warnings from the likes of Willis Towers Watson's Bill Dubinsky, who said it is "still far too early to close the book on the exact allocation of losses among insurers and reinsurers, let alone between traditional balance sheets and ILS", are a number of issues complicating the market's ability to get its arms around the HIM losses.

Chief among the complaints of those seeking clarity on the market's HIM losses is the growing question mark around Maria's impact.

Over the past few weeks, anecdotal evidence has pointed to a slightly better picture than first predicted for Harvey and Irma, with adjusters able to get on the ground relatively quickly after the events and begin their assessments. Cargo losses didn't look as bad as first feared and flood wasn't covered by much of the market.

Interestingly, Coles notes that adjusters were being brought into Houston to generate full damage reports so that, if they needed to reject a claim on the basis that the coverage did not include flood, they could point to independent evidence that the damage was caused by water and not wind.

Puerto Rico, however, is a different ball game. Getting on and around the island in the days after Maria struck was nigh on impossible, as Vince Cole, US CEO of Charles Taylor Adjusting, explains.

Huge amounts of infrastructure damage meant there was no power, no telecommunications, no traffic lights, nowhere to eat and nowhere to stay, he says. The time taken for simple tasks such as navigating around San Juan suddenly went from 20 minutes to four hours.

"The first month I had people describing Puerto Rico to me as a bit of a warzone," says Cole. "We had two guys there who were staying in tent and a rented home. The tent obviously had no power and the rented one only had a generator that worked for a few hours at a time.

"Meals were beef jerky and bottles of water. Another guy found a Starbucks after a few weeks and survived off eating their food for three or four weeks. It's not like they get a vacation in the Caribbean."

The terrain also caused problems, he says: "Getting around the cell towers in a mountainous region, finding them and all the bits and pieces and parts has been – and will continue to be for a year or so – a challenge."

Convincing adjusters to go to Puerto Rico was also a problem. Stories of poaching were rife. Cole agrees with other sources that fees for adjusters ramped up due to the quick succession of natural catastrophe events.

"It's not like we don't have enough resources as an industry, there were enough adjusters available, but when the events get stacked like this, you have to pay a little more for each subsequent event. So yes, the expenses are higher."

No more 3-for-2

The worrying thing as far as the (re)insurance market is concerned, is we're nowhere near obtaining a full Puerto Rico loss number.

"We don't have a handle on it yet, and the number of loss adjusters out there isn't as great as it should be for an event of this size," says Cole. "At this stage, I don't think we're even up to half of the total expected loss notifications... it'll be another 12 months before we discover what's fully going on there."

Elsewhere, there are also rumblings of potential legal disputes brewing – and not just in super-litigious Houston.

Several sources said debates were already happening around Irma and Maria, with disputes over coverage and aggregation issues and whether buildings and infrastructure were hit by Irma, Maria or both.

Finally, there is a big unknown in the form of how big a problem business interruption and contingent business interruption might prove to be.

It's too early to ascertain the impact this year's cats will have on rates in the upcoming January renewals, but there is a growing consensus that coverage levels will become a key talking point.

As Ark's Beaton explains: "Has anyone really been pricing in flood risk at anything more than marginally above zero? Bushfire – another huge issue this year, not just in California – when people were pricing that, were they putting in anything other than something approaching zero?

"Effectively what's happened is there's been a lot of 3-for-2 shampoo sold and people are now realising they can't do 3-for-2 anymore and need to put a proper price next to it. If you just want the coverage just for named windstorm, then let's give that restricted cover again.

"There's definitely a coverage conversation about what people want to buy and what people want to sell," he concludes.

Q3 cat losses – (re)insurer estimates ($mn)

	Harvey		Irma		Maria		Combined HIM		Combined HIM/Mexico	Combined HIM/Mexico
Company	**Range (if given)**	**Midpoint/ total**	**Range (if given)**	**Midpoint/ total**	**Range (if given)**	**Midpoint/ total**	**Range (if given)**	**Midpoint/ total**	**Range (if given)**	**Midpoint/ total**
Asian (re)insurers										
MS&AD	133-221	177	265-442	354	177-221	199	na	730	na	796
Sompo	na	216.5	na	333.7	na	72.2	na	622.4	na	631.4
Tokio Marine	na	187.4	na	285.5	na	80.3	na	553.2	na	580
Bermudian carriers										
Arch Capital	na	130	na	155	na	55	na	340	na	348
Aspen	na	110	na	135	na	65	na	310	na	360
Axis Capital	na	240	na	228	na	116	na	584	na	617
PartnerRe	na	na	na	na	na	na	na	472	na	na
RenaissanceRe	na	na	na	na	na	na	na	na	na	615
Validus	na	146.4	na	163.2	na	57.7	na	367.3	na	378.9
XL Group	na	na	na	na	na	na	na	1,330	na	1,480
European carriers										
Everest Re	na	na	na	na	na	na	na	na	1200	1,200
Hannover Re	na	na	na	na	na	na	na	na	na	838
Mapfre	na	48	na	79	na	102	na	229	na	295
Munich Re	na	na	na	na	na	na	na	3,200	na	3,800
Scor	na	na	na	na	na	na	na	na	na	699
Swiss Re	na	na	na	na	na	na	na	na	na	3,600
Global carriers										
AIG	1,100-1,200	1,150	1,000-1,100	1,050	600-700	650	2,700-3,000	2,850	na	3,000
Chubb	na	650	na	891	na	220	na	1761	na	1,786
London carriers										
Beazley	na	na	na	na	na	na	na	na	175-275	225
Hiscox	na	na	na	na	na	na	na	225	na	na
Lancashire	na	na	na	na	na	na	na	na	na	165
US insurers/groups										
Alleghany	na	265	na	312	na	170	na	747	na	793
AmTrust	na	na	na	na	na	na	na	na	na	54.2
Assurant	134-140	137	na	125	na	na	na	262	na	na
Berkshire Hathaway	na	na	na	na	na	na	na	na	na	3,000
Cincinnati Financial Corp	na	20	54-66	60	na	6	na	86	na	na
CNA	na	149	na	95	na	20	na	264	na	na
Enstar	na	na	na	na	na	na	na	39	na	na
Fairfax Financial	na	na	na	na	na	na	na	929.5	na	959.5
James River	na	na	na	na	na	na	na	10	na	na
Kemper	na	na	na	na	na	na	na	29.8	na	na
Maiden Holdings	na	na	na	na	na	na	na	20	na	na
National General	25-30	27.5	na	na	na	na	na	27.5	na	na
US nationwide										
Allstate	na	576	na	na	na	na	na	593	na	na
The Hartford	na	175	na	157	na	na	na	332	na	na
Travelers	na	na	na	na	na	na	na	700	na	na
US specialty										
AIG	na	na	na	na	na	na	na	na	na	105
Argo	na	na	na	na	na	na	na	na	na	104.5
Markel Corp	na	na	na	na	na	na	na	na	na	503
Navigators	na	na	na	na	na	na	na	na	na	75.1
RLI	na	na	na	na	na	na	na	32	na	na
WR Berkley	na	na	na	na	na	na	na	na	na	107
Other										
Citizens	na	na	na	1,230	na	na	na	1,230	na	na
Liberty Mutual Group	na	630	na	800	na	340	na	1,770	na	na
Lloyd's	na	na	na	na	na	900	na	4,800	na	na
Nagico	na	na	na	400	na	150	na	550	na	na
QBE	na	na	na	na	na	na	na	na	na	600
Zurich	na	na	na	na	na	na	na	700	na	na
								TOTAL: $26.7bn		**TOTAL: $27.7bn**

Note: Fairfax Financial figures include Brit and Allied World results; Sompo includes Canopius and Sompo International; MS&AD includes MS Amlin
All loss numbers are pre-tax and net of reinsurance and reinstatement premiums

Source: Company announcements, *Insider Quarterly*, as of 13 December

HISTORY REPEATING

Third quarter catastrophe losses have sharpened the focus on a broken National Flood Insurance Program, writes **Ted Bunker**

Even before Hurricane Harvey dumped over four feet of rain over Houston and inundated America's fifth-largest metropolitan area, Washington policymakers knew the insurance system set up to help Texans deal with such events was broken.

But Harvey underlined that assessment in bold red type.

The National Flood Insurance Program (NFIP), run by the Federal Emergency Management Agency (Fema), was already drowning in debt from earlier hurricanes because it was never set up to deal with catastrophes on the scale of Hurricane Katrina, Superstorm Sandy or this year's Harvey.

The programme was established in the Great Society era of the 1960s to provide flood cover where private insurers feared to tread, mainly along low-lying shores and riverbanks. It was not set up, however, to provide a catastrophe fund.

Because NFIP rates aim to meet the needs of insureds during an average year, its finances were easily overwhelmed by flood losses in New Orleans during Hurricane Katrina and from metro New York and New Jersey following Sandy.

The latter two storms alone left the programme owing over $20bn to the US Treasury, and flooding in Louisiana from heavy rains last year raised it past $25bn – bring losses ever closer to the approximately $30bn cap on the NFIP's borrowing capacity.

With depictions of Harvey's devastation fresh in their memories, Washington lawmakers – prodded by President Donald Trump – cancelled $16bn in NFIP debt.

But that only cleared some headroom to cover an estimated $11bn loss from Harvey, not to mention claims from hurricanes Irma and Maria.

At the same time, Congress resisted taking what had, as recently as last year, been regarded an uncontroversial step to let more private carriers into a flood market nearly monopolised by the NFIP and its subsidised rates.

As part of its debt cancellation request, the Trump administration asked lawmakers to change the rules and let private flood cover suffice when a property or business in a designated flood hazard area had a federally backed loan. The Senate balked.

Barriers to entry

While that same step won unanimous support in the House of Representatives last year, passing without a single vote against it as analysts applauded the move, dozens of House members opposed it this year.

In the Senate, Louisiana Republican Bill Cassidy had the provision stripped from hurricane relief legislation in September. The Senate blocked the step again last month as it cancelled roughly half of the agency's Treasury debt.

Democrats and a few coastal state Republicans have argued against the market-opening step, characterising it as a threat that would undermine the NFIP's finances by letting private carriers strip away less risky insureds from its nearly 5 million policyholders, leaving it with less revenue to cover costs such as rate subsidies.

According to Pew Trusts analyst Laura Lightbody, some opponents insisted on a companion measure requiring private carriers that write the business to support funds set up for flood mitigation work or for claims from repetitive loss properties – those with two or more NFIP claims.

Supporters of opening the market have argued that getting more private carriers to write flood cover will be hard enough without adding costs, as new entrants would have to compete with the below-market rates often offered by the NFIP, as well as shouldering substantial risks.

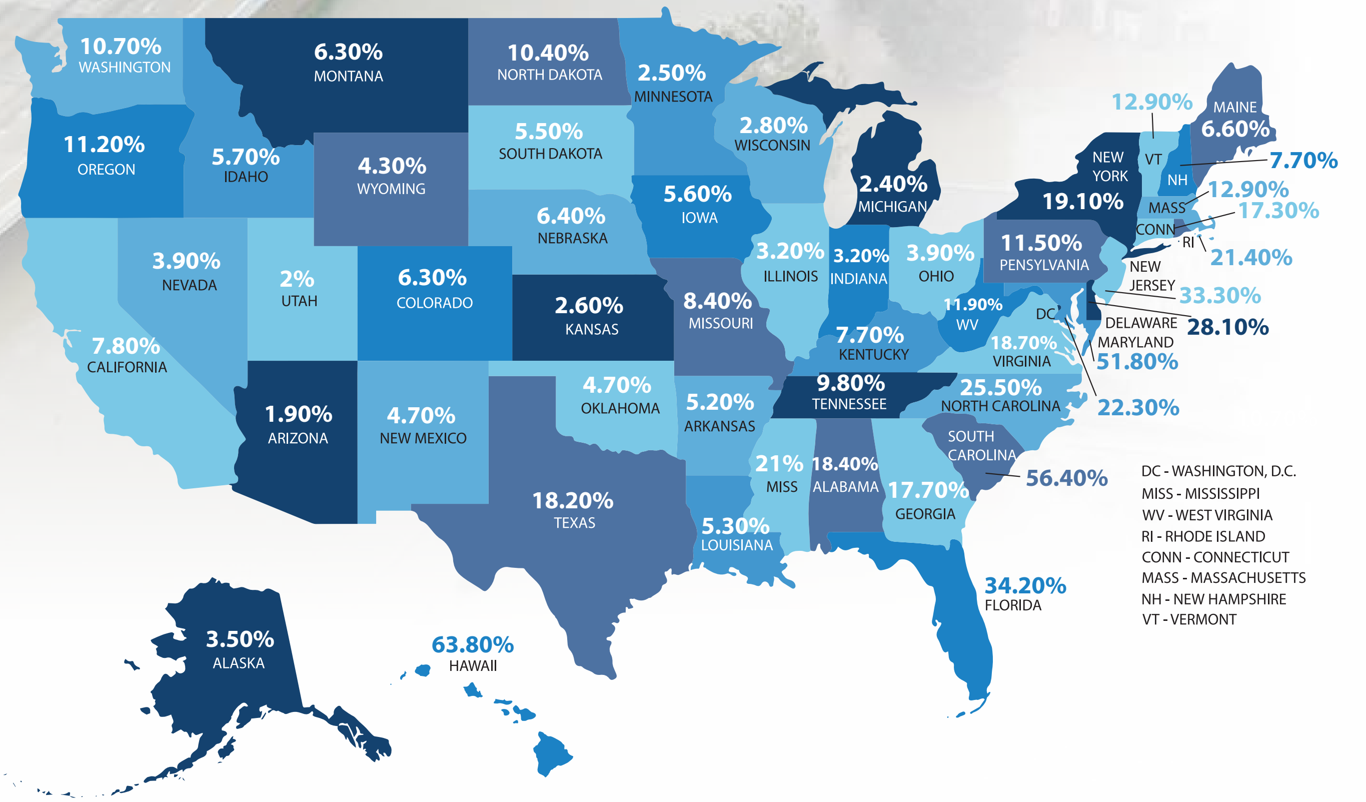
Flood is the most common and expensive natural disaster in the US, according to the Insurance Information Institute. Last year produced 15 natural disasters that cost $1bn or more, including a record number involving inland flooding, the Union of Concerned Scientists has reported, citing federal data.

Backers of reforms cite the wide and apparently growing gap between insured and at-risk properties as reason enough to end a policy that virtually requires a large portion of the market to buy NFIP cover. And it is a void many insurers see as an

Continued on page 16

Who's covered?

Percentage of properties with NFIP policies in force versus those at risk but lying outside Fema flood hazard areas



Total US 16.80%

attractive opportunity, under the right conditions.

"The gap in flood insurance protection represents up to a $40bn potential new market for private insurers," Guy Carpenter executives said in a recent commentary.

The flood risk gap

CoreLogic, a real estate data and analytics company, published a report in December showing how wide the gap can be between areas where NFIP cover is required on homes and businesses with federally backed loans, and areas at moderate-to-high risk of flooding but which lie outside Fema flood hazard areas.

The map on page 15 shows the ratio of NFIP policies in force versus the number of properties at moderate-to-high risk of flooding in each US state, but which lie outside Fema flood hazard areas (expressed as a percentage).

In total, Fema said there were over 4.9 million NFIP policies in force at the end of September. CoreLogic has estimated that around 29.4 million properties with moderate-to-high flood risk lie outside Fema-designated flood hazard zones, where there is no legal or regulatory mandate that requires NFIP coverage.

Presumably, therefore, a significant proportion of those 29.4 million properties lack flood coverage, which is typically excluded in homeowners' insurance.

Following Superstorm Sandy, statistics showed that 80 percent of residents in affected areas lacked flood cover for their homes, according to TransRe flood leader Elizabeth Geary.

Getting more property owners to buy flood cover is regarded as a vital prerequisite to repairing a market that the government, whatever its intent, has long skewed through intervention, analysts say.

The trick to creating a more viable (and largely private) market is getting more property owners to pick up the coverage, and one way to accomplish that involves helping them recognise their flood risk. Disasters like Harvey raise awareness significantly. The Council of Insurance Agents & Brokers said its third quarter 2017 member survey showed a 64 percent increase in demand for flood coverage and a 59 percent jump in flood-related claims.

Raising awareness

Analysts see some good coming from these impacts.

"We're hoping that once people recognise their true flood risk, there's a greater take-up rate," Geary says.

When the door to private carriers has been pushed open, they have entered. In Florida, where state lawmakers passed legislation to ease lender concerns about flood coverage requirements in 2014, there are now some 16 companies writing the risk, Geary said in a recent interview.

> A Pew study found that about 1 percent of the properties covered by NFIP policies – approximately 150,000 – have accounted for as much as 30 percent of the programme's losses since the 1970s

The state also has the largest number of NFIP policies in force, at 1.73 million, Fema data shows.

But getting Congress to take a similar step has proven increasingly difficult, as recent actions in the nation's capital show.

Veteran lobbyist Alan Rubin is a principal in law firm Blank Rome's government relations practice who has been working on disaster preparedness and recovery financing for decades. He notes that attention to the subject often heats up following a catastrophe. "Then it's hurry up and wait," he says.

Rubin adds that when it comes to issues like mitigation to prevent or minimise flood damage: "The question is, are we willing to spend the money – and then find a way to get back the money?"

"It's absolutely doable," he continues. "It is all about the political will."

But government is often reactive rather than proactive, which means resources flow into recovery efforts first and then into mitigation after destructive events like Harvey, Irma and Maria.

Rubin notes that often as disasters recede into history and recovery progresses, efforts on preventive mitigation lose steam.

As a result, he says: "We're not doing the things we need to do."

The dynamics from a political perspective are not difficult to grasp.

"It's very hard – and it's understandable," Rubin says. "It's very hard to get legislation when the danger isn't imminent."

Analysts also agree that once government bestows a benefit, such as guaranteed flood insurance at discounted rates, it can be very difficult to get lawmakers to take it away, especially if it involves a real cost or hardship.

Political sensitivities

But the need for change has become glaringly obvious. A Pew study found that about 1 percent of the properties covered by NFIP policies – approximately 150,000 – have accounted for as much as 30 percent of the programme's losses since the 1970s.

Repetitive loss properties accounted for $12.5bn in NFIP losses before this year's hurricanes, the nonpartisan non-profit organisation says. It cites as an example the $663,000 the NFIP paid out on claims for a Mississippi home with a $69,000 market value that had flooded 34 times over 32 years.

Pew estimates that the NFIP has paid out more in claims than the property is worth on 10 percent of all repeat-loss properties. The bulk of these properties are located in Florida, Louisiana and Texas – the top three states in terms of NFIP policies in force – and New Jersey and New York.

Texas, New York and Florida rank among the largest states by population and between them have 108 representatives in the House and 10 Senators – roughly 25 percent of the House and 10 percent of the Senate.

While lawmakers from the five states may not be much influenced by the plight of repetitive loss property owners, the breakdown helps illustrate why changing the NFIP can be so politically difficult.

A reform package passed by the House, largely along party lines but with defections on both sides, contains several mitigation measures aimed at easing the costs of repetitive loss properties.

The measure would phase out rate subsidies, mandate a $5,000 minimum deductible and allow the NFIP to withhold coverage if the owner refuses a mitigation offer. The measure would also bar properties where claims payments have exceeded three times the structure's replacement value from eligibility for NFIP coverage.

Opponents have cited provisions like these as fatal flaws in the legislation, which has not moved forward in the Senate.

In the White House, President Trump has thrown his support behind the House reform measure. But the issue has taken a backseat to efforts to provide disaster relief and pass a sweeping tax reform bill, which the president has urged lawmakers to send over before Christmas. As a result, most observers expect another extension of the NFIP's authorisation to keep it going into 2018, but without any reforms.

Reforming the NFIP

A $44bn disaster relief bill remains pending in Congress and could provide a vehicle for a further NFIP extension. That measure includes $12bn in flood risk mitigation funds to be distributed through community development block grants rather than by the NFIP. Alternatively, the issue could be attached to another measure, called a continuing resolution, to extend overall government spending authority and keep all federal departments open and operating. The last NFIP extension, for two weeks, was included in such a bill.

When it comes to the multifaceted issue of NFIP reform, analysts and observers agree that overhauling the broken system will come down to mustering the political will to fix it. And that will depend on the leaders of both parties, as well as the president.

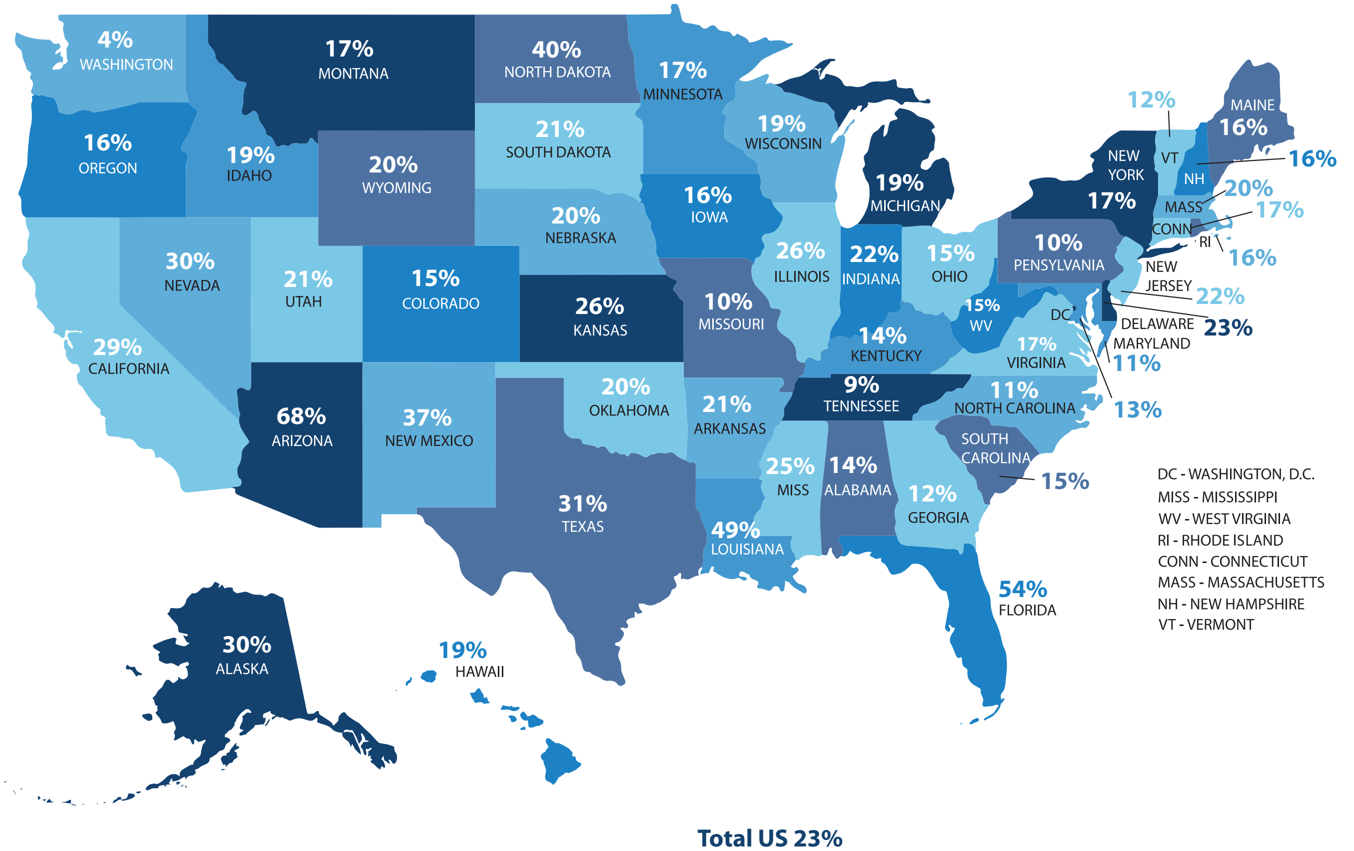
"It's really a matter of leadership to get something done," Pew's Lightbody says.

After this year's HIM losses are added to the tally, Blank Rome's Rubin says the NFIP's debt may be nearing $40bn, which may serve to keep the focus on addressing the programme's flaws.

Fixing it is critical, he suggests: "If we continue to make the same mistakes, the problems are just going to repeat, over and over."

Outside the zone

Percentage of properties at moderate-to-high risk of flooding outside of "special flood hazard area" designation



POLES APART

Why were modelled estimates of industry losses from hurricanes Harvey, Irma and Maria so diverse, asks **Lucy Jones**

Hurricane Maria makes landfall in Puerto Rico

As the Caribbean islands of Dominica and Puerto Rico lay in ruins following Hurricane Maria, the industry's leading modelling agencies issued two vastly different views of the event.

RMS estimated insured losses from Hurricane Maria at \$15bn-\$30bn, while AIR Worldwide put out a range of \$40bn-\$85bn, of which losses in Puerto Rico were pegged at \$35bn-\$75bn. AIR later revised its estimate to \$27bn-\$48bn, of which \$25bn-\$43bn related to Puerto Rico.

More than two months on, while modellers stand by their numbers, the industry at large is asking why the estimates are so diverse, whether models are delivering value for money given the huge loss ranges and whether pricing reflects the model uncertainty that has emerged.

The disparities in industry loss estimates for Puerto Rico partly come down to a lack of information following the event.

Weather stations which measure wind speed failed during Maria, which meant both AIR and RMS had to fill in the gaps.

But the explanation can also be traced back to the inputs that risk modellers begin with – their assumptions on what properties are at risk from a storm.

Hazard risk

Hurricane Maria has revealed vastly different assumptions taken by AIR and RMS on the vulnerability of buildings in Puerto Rico.

AIR assumed wind damage would have occurred to the vulnerable upper stories of buildings in Puerto Rico, which are usually made of wood. However, RMS took the view that the island's bunker-style buildings would have been able to successfully resist the storm.

On the commercial side, Michael Young, head of Americas climate risk modelling at RMS, says that local pharmaceutical facilities, which make up half the company's exposure base for Puerto Rico, are also built to be incredibly resilient.

"The losses we expect to come from that particular sector tend to be quite low," he says.

Puerto Rico's manufacturing industry has shrunk by a third over the last 10 years, so neglecting to include this trend could lead to exaggerated losses, RMS notes.

The modelling agencies also appear to differ in their views of how quickly the island will recover and how much that recovery will cost.

On a reconnaissance trip to the island shortly after the hurricane, an RMS team found the Puerto Rican capital San Juan mostly operational. Businesses were using fuel-powered generators as part of hurricane preparedness. New hotels had performed well in withstanding the hurricane and were open.

AIR says the cost of Puerto Rico getting back on its feet could be significant, however.

"After an event of this size, cost of repair and cost of labour is not the same as before the event, as you have shortages on the island," says Cagdas Kafali, senior vice president in AIR's research and modelling group.

Some 30 percent of AIR's uppermost insured loss estimate of \$43bn for Puerto Rico is attributed to this so-called "demand surge".

Converging views

One might expect that in the insurance market's exposure hotspot of the US the risk models would demonstrate greater convergence – and, indeed, this was the case for Hurricane Irma's impact on Florida.

Continued on page 20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AIR published an estimate of $32bn-$50bn for Irma, including $25bn-$35bn of US insured losses. The figures from RMS were in the same ballpark, with insured losses estimated at $35bn-$55bn, of which US private losses constituted $22.5bn-$29.5bn.

Claire Souch, director of cat risk modelling consultancy AWHA Consulting, says that the high frequency of big US hurricane events in the past 10 years has helped to develop modelled research. But for a big US flood event, such as Harvey, there is less past experience and therefore more uncertainty, she says.

For Harvey, AIR has not provided an insured loss figure for flooding but has instead issued an overall insurable loss figure of $55bn-$65bn.

RMS has given a figure of $25bn-$35bn, which includes $7bn-$10bn incurred by the US government-backed National Flood Insurance Program, plus $18bn-$25bn of commercial insured losses. RMS does not have a US flood model (it will be launched next year), whereas AIR does.

Chaos modelling

Modelling involves determining the hazard, vulnerability, exposure and locations of risk impacted by an event. However, according to Andrew Castaldi, head of catastrophe perils Americas at Swiss Re, there should be a fifth box – the modelling of unexpected components of an event, which he terms "chaos modelling".

"For example, engineering studies are looking at a particular building and how it will react within a wind field, but in reality you would have many other structures around it with, for example, gravel in the roof which turns into debris," he adds. "How is your risk impacted by an event when it is surrounded by a community of other risks?"

Some might say that's underwriting judgement but others might say it belongs in a model, he continues.

Castaldi goes as far as to say that by not looking at the exaggerations that might occur insurers could be leaving themselves in jeopardy.

"Maybe ratings agencies and regulators will start looking at these experiences and will say, 'Maybe we should look at a modelled loss, plus a certain percent to include these impacts'," he says.

Market view

The disparities in model outlooks have certainly been a cause for concern across the market.

"If a Category 4 on Puerto Rico can cause up to $80bn of loss, what would a Category 5 in Miami/Tri-County really cost?" one insurance-linked securities market source questions.

"Are licensees who use the model loading their pricing sufficiently for such huge model uncertainty?" the source adds.

Another source says the cost of taking on risk should go up, given the model uncertainty recent events have brought to light.

The uncertainty of models has occupied a less prominent position in decision makers' minds until now, but that needs to change, the source says.

But even though models differ and the ranges for individual events can be vast, insurers still reiterate their basic value to risk takers.

Having a range of views is useful and necessary, says Shree Khare, group head of catastrophe research at Hiscox.

The reinsurer's process for assessing a large loss includes taking into account the judgement of its underwriters and catastrophe modelling teams, market estimates of the industry loss which give insight into potential losses to individual carriers, specific modelled events from its modelling partners and knowledge of specific risk losses.

"Given the multiple sources of uncertainty in loss estimation, I'm not surprised to see a large range of losses from any particular vendor," he says. "Furthermore, I'm not surprised to see disparities between model vendors." However, Khare adds, it would also be useful to understand the drivers behind each of the vendor's given ranges.

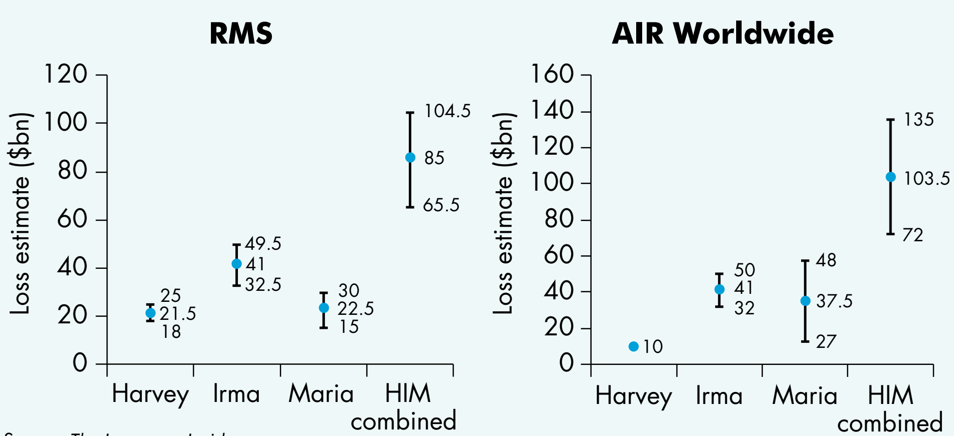
Harvey, Irma and Maria have provided Hiscox and others in the industry with a huge opportunity to update their view of risk and learn and work with customers to improve their understanding of their exposures.

"Harvey is a good example of this, given [that] it stalled over Houston and caused an unprecedented amount of flooding," says Khare.

Vendor models tend to be a sanity check, says Castaldi. "If someone is between $5bn and $15bn and we're in that $8bn range, then we feel comfortable but if we're in a $30bn then we will have to look at what went wrong.

"No model is ever going to be perfect or exact but it's going to be enough to protect you from going bankrupt," he concludes.

HIM loss estimates



Source: *The Insurance Insider*

EVERY CLOUD...

Hurricanes Harvey, Irma and Maria are one of the biggest tests the alternative reinsurance sector has faced since it came of age, but the market has quickly rebounded, finds **Fiona Robertson**

Hurricanes Harvey, Irma and Maria (HIM) were not the nightmare event for insurance-linked securities (ILS) managers that some might have anticipated, but as the (re)insurance industry began totting up costs from the windstorms, concerns began to mount that some losses were going astray.

While industry losses from the full roster of natural catastrophes in the third quarter of 2017 were generally expected to range between $80bn and $100bn, the claims tally emerging from individual company results was initially perceived to be falling well short of this total.

Undoubtedly, some of the fear about the potential scale of alternative reinsurance market losses was due to the fact that there is less public visibility on the ILS market claims burden.

But a general consensus has begun to emerge that the ILS market could pick up as much as 25 percent of total industry claims, a figure cited by AM Best chief rating officer Stefan Holzberger during a November conference hosted by the ratings agency.

Where ILS losses fell

Hurricane risk is the ILS market's greatest area of exposure – but Harvey, Irma and Maria all presented such different challenges that they impacted ILS managers in an uneven way.

Retrocession specialists bore the brunt of the losses as the aggregation of claims mounted, while the cat bond market escaped relatively lightly.

This also contributed to the opacity over ILS losses – as the cat bond sector is the more public part of the market, while retro writers sit at the end of the risk transfer chain and may have difficulty establishing their losses as they flow through the market.

As much as half the ILS market's claims could be related to retro losses, said Hannover Re's managing director of retrocession and capital markets Henning Ludolphs, speaking alongside Holzberger at the AM Best conference.

This suggests a figure of around $10bn – an estimate corroborated at a Florida event by Aon Benfield president Andy Marcell, who said his firm had tracked around $20bn of impacted retro limit, with around $9bn of collateral affected.

Collateralised reinsurance losses will have varied by the risk level of individual strategies, but the average recorded by the ILS Advisers index, which tracks 34 funds, came to a 9 percent loss in September. The year-to-date result for the first 10 months was a 6.91 percent drop.

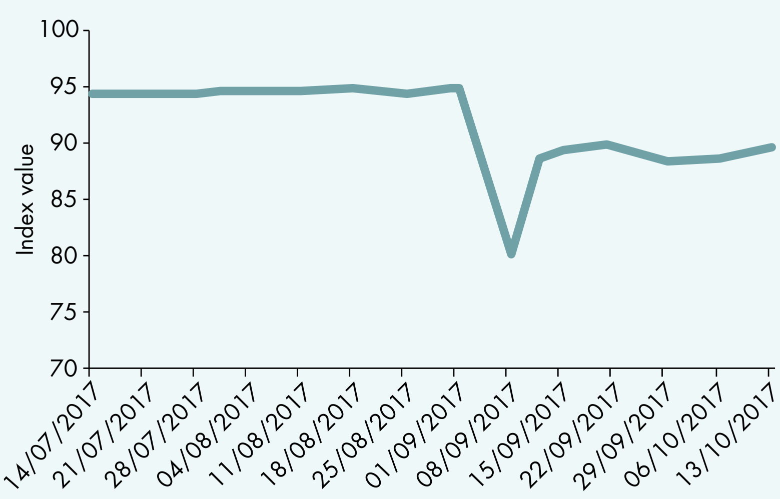
In 2011, the only other year it was negative, the ILS Advisers index posted a 0.14 percent annual loss.

At the other end of the scale, cat bond instruments are largely designed to respond to notably large single events, not the kind of mid-level hurricanes that Harvey and Irma were in terms of insured losses.

The Swiss Re global cat bond price return index was down 5.4 percent over the course of September and October – suggesting a writedown of around $1.25bn to the roughly $25bn market.

Many of these losses would have been unrealised mark-to-market writedowns, although some small Florida bonds and high-risk annual aggregate deals were expected to

Cat bonds bounce back from HIM storms



Source: Swiss Re Capital markets, *Trading Risk* respond to claims.

However, it was not one of the three major hurricanes but rather a Mexican earthquake that triggered the cat bond market's first and largest confirmed loss from the 2017 catastrophe activity, through the $150mn World Bank parametric deal for Fonden.

This is the cat bond market's largest single payment since the 2011 Tohoku earthquake, which triggered a $300mn cat bond payout.

In the industry loss warranty (ILW) market, the Micrix ILW index fell 12 percent after the September hurricanes – indicative of around a $720mn loss in a $5bn-$7bn overall market.

However, the index does not track the performance of any aggregate ILW triggers and is globally diversified, so actual ILW losses would be expected to be somewhat higher than this, as the market is heavily geared to the US and includes some aggregate cover.

The bulk of the ILS market's losses will be in reinsurance and retrocession, with more exposure to Irma (as it falls in their hotspot of Florida exposure) than to Maria, where traditional market share is higher and exposure would be mostly via retro or sidecars.

But with some ILS managers building up insurance books in recent years, they will also share "a small but not insignificant portion" of primary market losses, according to Willis Towers Watson Securities' head of ILS Bill Dubinsky.

"It is still far too early to close the book on the exact allocation of losses among insurers and reinsurers, let alone between traditional balance sheets and ILS," he says.

Moreover, JLT Capital Markets co-heads of ILS Michael Popkin and Rick Miller point out that the issue of trapped collateral complicates the ILS market's exposure. This concerns capital that is not expected to be a loss currently, but which is being held over by a buyer in case claims rise to trigger a contract.

Equally, just as traditional reinsurers have bought retro to reduce their net losses from HIM, ILS managers have also hedged their portfolios.

"Thinking about how ILWs might have played into all of this could make one investor seem more exposed on the surface, but very well hedged beneath the surface," Popkin says.

ILS market segment loss projections

	Projected loss ($bn)	Estimated total size ($bn)	Assumptions
Collateralised reinsurance	5	35	Taking 15% loss as average based on 10%-20% losses reported by some funds tracked by ILS Advisers index
Indemnity retro	5	11	Assuming 42% loss based on Catco's return
Sidecars	4	8	Based on DaVinci Re loss
ILWs	1	6	Based on 12% Micrix index loss, multiplied by 2 to account for higher US/aggregate exposure
Cat bonds	1	25	Based on 5% writedown to Swiss Re index
Total	16	85	

Source: *Trading Risk*

2017 loss experience

This year's hurricanes have come after a run of favourable years for the (re)insurance markets. So were ILS investors prepared for losses such as these?

While this year's losses may have been extensive, cat bond specialist and Fermat Capital Management co-founder and managing director John Seo says he ranks the 2017 events in only fourth place behind 1992, 2005 and 2011 in terms of their market impact.

This takes into account the "surprise factor" of losses as well as the impact on capital levels, rather than just nominal loss totals.

"The losses this year are big enough to check an investor's commitment, but not big enough to shake an investor's faith," Seo adds.

Cat bond losses have been in line with modelled risk profiles, but Seo highlights that the return period of major losses depends greatly on their definition and scope.

So while some are talking about a 1-in-40-year loss experience, Seo argues that this year's cat bond market losses are modelling as closer to a 1-in-10-year aggregate loss.

"If we put 2017 alongside 1992, 2005 and 2011, we would be seeing four similar or greater loss years across three decades."

That said, the 2017 loss experience has primarily highlighted where the ILS market's pockets of aggregate exposure lie – and the extent to which some retro strategies are far more exposed to a 1-in-10-year aggregate loss than they are to a 1-in-100-year single hurricane.

"This was primarily a retro event," Seo says. "Retro events should be expected to happen every three to eight years."

At more of a micro level, Willis Towers Watson's Dubinsky highlights loss adjustment expenses as a possible exception to the general rule that investors have not materially changed their view on risk following the 2017 events.

As Harvey and Irma followed each other in quick succession, Florida carriers faced difficulties in recruiting loss adjusters, which put expenses well ahead of the usual assumptions.

"Traditional contracts bore the full brunt of the some of the adjuster shortages but factor-based contracts such as the [Florida Hurricane Catastrophe Fund] and reinsurance backed by cat bonds did not," Dubinsky explains.

Post-loss reloading

The 2017 hurricane season has kept everyone in the reinsurance market busy, but spare a thought for ILS managers juggling multiple challenges in the run-up to the 1 January renewals.

Not only do they need to accurately assess losses and communicate

Continued on page 24

with reinsurance buyers about their expectations for renewals, they also have to figure out what kind of post-event pricing opportunity might be available and communicate with their investors to raise fresh capital to replace lost and trapped collateral.

Mother Nature was on their side, in that the hurricane losses occurred midway through the season, giving ILS managers at least a couple of months to accomplish this ahead of 1 January.

Speaking in late November, Dubinsky says that most investors seem reasonably well positioned to trade forward.

Indeed, he suggests that some managers may even use the 2018 renewals as an opportunity to "grab market share intelligently both from traditional reinsurers and from other investors".

"This shift will only occur if incumbents push price and give investor newcomers the opportunity to do so, whether in cat bond form or in private transactions," he notes.

Some ILS managers had waiting lists for new investors before these events and pointed to this pent-up demand as a factor that would assist with reloading their capital.

Moreover, this year's activity has drawn interest from investors that have been sitting on the sidelines of the market, commentators observe.

When it looked like Hurricane Irma was going to hit Miami, Andre

John Seo, co-founder and managing director, Fermat Capital Management

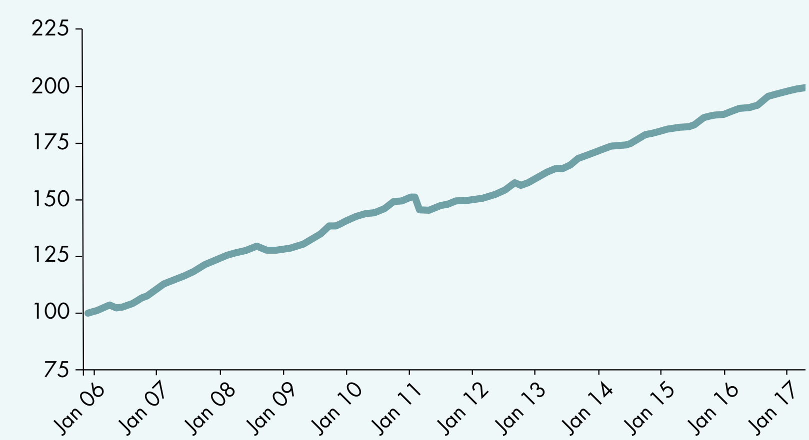
> This was primarily a retro event. Retro events should be expected to happen every three to eight years

Perez, CEO of ILS service provider Horseshoe, said the firm was involved in preliminary fundraising talks that could have brought in $3bn of capital over the course of just two days.

"We're seeing investors coming back, who haven't been back since post-KRW [Katrina, Rita, Wilma]," Perez said at the October *Trading Risk* New York conference. "I think it is a great opportunity for ILS funds to raise more capital."

But as Irma drifted clear of Miami and it became clear that the HIM losses would be highly manageable for the reinsurance market, the issue of how much of a ratings reaction would follow raised a question over whether opportunistic investors would be willing to move back into the market.

ILS Advisers index returns



Source: Eurekahedge ILS Advisers

The yield question

Ultimately, the key question for investors considering their ILS strategy for 2018 will be how much additional compensation they can expect to earn post-loss.

But as alternative reinsurance capacity now plays such a significant role in the catastrophe reinsurance segment, the overall reaction is expected to be far more subdued and controlled than after the capital shock loss of Hurricane Katrina, for example.

JLT Re North America CEO Ed Hochberg says the firm is expecting the diversity of capital sources available to buyers to have a "dampening" effect on the pricing cycle, but notes that the impact will not be uniform.

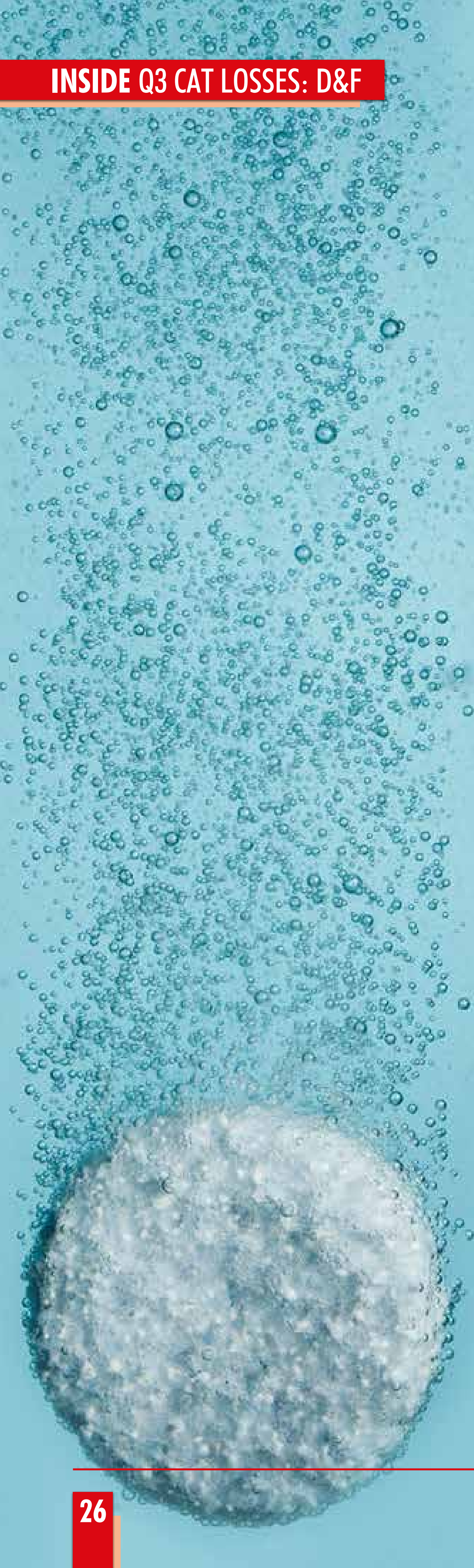
"Some parts of the market will see more price adjustments (i.e. loss-affected programmes) than other segments and the persistency will not be the same everywhere," he says.

Ultimately, given that the cat bond market rebounded quickly from the 2017 losses, Seo is expecting this market segment to attract new strategic sponsors as a result.

This is being influenced by reinsurance buyers shifting their emphasis away from obtaining annual rate decreases towards rate stability, he explains, with the cat bond market offering multi-year cover that can smooth out the impact of losses.

"We should expect next year to be yet another record issuance year in the cat bond market," Seo forecasts.

For the alternative sector at least, there has proved to be a silver lining in the clouds of this year's hurricane losses.



RAPID RELIEF

The facultative market is likely to take a hefty hit as a result of Q3 cat losses, but hardening rates and tightening T&Cs could make renewals less of a headache for D&F writers, finds **Marcus Alcock**

It was a brutal third quarter for (re)insurers, and there can be little doubt that the facultative reinsurance market has taken a significant proportion of overall insured losses.

While hurricanes Harvey and Irma may have been more meaningful for treaty reinsurers, there can be little doubt that Maria's devastating impact, especially in Puerto Rico, combined with Mexico's two powerful earthquakes in what must surely count as one of the fac heartlands, has hit hard.

As if this were not bad enough, along came the ferocious wildfires in northern California, ripping the heart out of many wineries. Underwriters and brokers alike have been struggling to catch their breath.

There is certainly an expectation among analysts of a significant wider market hardening following these events. Morgan Stanley, which has suggested Q3 industry losses could total more than $100bn, said the significant impact to earnings and industry capital, current low P&C pricing and the potential lock-up of alternative capital could mean double-digit rate increases in property cat reinsurance, and potentially more in the retro market.

Senior management has also supported the need for firming, especially in the property reinsurance market. RenaissanceRe CEO Kevin O'Donnell said he believed there was far more volatility in the reinsurance sector than many appreciated, after a period where there was a dearth of US catastrophe losses.

"Years like 2017 are not outliers," he commented on a recent analyst call, adding that similar aggregate industry losses could be expected every 10 years. "As a sector, we haven't been paid [for] this volatility for too long now," he said.

Indeed, although reinsurers have warned that it is still too soon after hurricanes Harvey, Irma and Maria (HIM) to take a meaningful look at pricing conditions (given that many significant programmes, especially for the fac market, are some way off renewal), there is still an expectation that firming of facultative reinsurance rates could now be around the corner.

For example, Munich Re management board member Hermann Pohlchristoph has argued that "pricing has to do with the whole portfolio. From the sheer size I would be very surprised if we are not to see higher rates across the globe, definitely in property cat, but it goes further".

Swinging a cat

Where fac writers are concerned, there also seems to be little doubt that for cat-affected accounts the rate on line will swing upwards by over 20 percent, and possibly even more where writers are confident of retaining the business.

Indeed, substantial localised property cat rate rises are now on the table for US, Caribbean and Mexican risks, with facultative underwriters suggesting that a number of discussions about price increases have occurred in recent weeks, both on the direct and reinsurance side, as well as talks around tightening terms and conditions.

The feeling seems to be that clients, especially those in heavily affected regions such as the Caribbean, appreciate that the market dynamic is now one where rates can only go one way.

Although areas that haven't been affected as much will no doubt push back on price hikes, one Miami-based fac reinsurer says: "The combination of Lloyd's taking a stand on pricing, in combination with these losses, will probably have an impact on prices in the property fac market."

Hannover Re CEO Ulrich Wallin, speaking on the carrier's Q3 and nine-month earnings call, said he was already seeing evidence of a firming of the reinsurance market on the P&C side "more or less across the board", including on loss-free business.

"[For the market overall], it's still early days, but what we have seen – particularly in the London market on the facultative business – clearly points to increases," he added.

Wallin went on to note that even Asian clients had "some sympathy" for increased pricing. Referencing 2011, when the global market saw an increase in pricing despite a year of mainly Asia Pacific-based losses, Wallin said Asian cedants "expect a similar movement for their markets for the current year".

The Hannover Re CEO told analysts that after 2011 the industry had broadly recorded an overall increase in rates of 7 percent, and that this "should be achievable this time around as well", with loss-affected accounts securing significantly higher increases.

One London-based fac broker says the buying dynamic for cat-affected regions is clear: "I'd say that there's little doubt, especially in loss-affected territories, that what's happened will have a marked impact for many cedants, and we're certainly seeing that in conversations we're having.

"Where fac writers are concerned, there seems little doubt that for cat-affected accounts the rate on line will swing upwards by over 20 percent, and possibly even more where writers are confident of retaining the business"

"In many ways it's continuing the pattern of recent years, where those insurers that had decided to increase retentions and centralise purchasing have decided to go back to the fac table because they've been hit by losses, though of course this is [a] much wider spread. I guess we'll have a clearer picture over the coming months."

Latin surge

For territories such as Puerto Rico and Mexico the expectation of double-digit rate rises for the property fac market is hardly surprising given their contribution to the overall loss burden, with much of this share likely to be absorbed by fac writers.

As such, comparisons are being made with the 2010 Chilean quake, for which the fac market faced some 50 percent of all claims.

From a buying perspective, Mexican fac will be of keen interest given the scale of potential earthquake losses – the Chiapas Civil Protection Agency has reported that more than 54,000 homes in the state were damaged, with 98 healthcare facilities and 129 public buildings also hit, as well as roads, highways and bridges.

Fac writers will be hurting given the structure of the Mexican (re)insurance market. The market can be largely split into three distinct areas: Fonden (Fondo Nacional para el Desarrollo Nacional, or the Federal Funds for Natural Disasters), government-owned entities, and private businesses.

The Fonden schemes are run by individual states, which buy programmes to cover the vast majority of uninsured Mexicans and are designed to be the first form of response, covering homes as well as some government-owned infrastructure assets, with a federal umbrella, or "Super Fonden", on top of the states' covers.

The Puebla, Veracruz, Mexico City and Chiapas Fondens are especially likely to be heavily

Continued on page 28

Harvey, Irma and Maria – industry loss estimates ($bn)

	Harvey		Irma		Maria		Combined HIM		
Company	**Range**	**Midpoint/ Total**	**Range**	**Midpoint/ Total**	**Range**	**Midpoint/ Total**	**Range**	**Midpoint/ Total**	**Notes**
AIR Worldwide	na	10	32-50	41	27-48	37.5	72-135	103.5	
CCR	na	na	na	7	na	na	na	na	Losses relate to French Caribbean collectivities of Saint Martin and Saint Barthélemy only
CoreLogic	17.5-52.9	21.7	22.5-27.0	24.75	na	na	na	na	
Insurance Council of Texas	na	8	na	na	na	na	na	na	The ICT estimate relates to Texas only; an additional $11bn of loss is allocated to the NFIP
Karen Clark & Company	na	na	na	25	na	30	na	na	The KCC Irma estimate is split $18bn for the US and $7bn for the Caribbean
Munich Re	20-30	25	na	na	na	na	na	na	
PCS	na	15.9	na	18	na	21.9	na	55.8	
RMS	18-25	21.5	32.5-49.5	41	15-30	22.5	65.5-104.5	85	An additional $7bn-$10bn of losses for Harvey and $2.5bn for Irma are allocated to the NFIP

Source: *Inside FAC*, Company announcements, as of 13 December impacted by recent catastrophes, and are disproportionately reinsured in London. The federal government also insures many of its services (for example schools, medical facilities, electricity and water) in the facultative market, with several likely to have substantial losses.

Drilling down into the figures, AIR Worldwide said insured losses from the first temblor, which struck off the coast of the state of Chiapas on 7 September, would be between 14bn pesos and 20bn pesos ($787.6mn-$1.1bn).

However other estimates point to much higher market losses – and hence a bigger hit for fac writers. Indeed, the two major earthquakes which hit the country in September could cost the (re)insurance market up to $5.9bn. Risk modelling agency Evaluación de Riesgos Naturales, which has worked with the Mexican (re)insurance market as well as consulting with construction experts across the region, estimated that insured losses to the market could top out at $4.8bn for the 19 September Puebla quake.

When it comes to fac renewals, although we aren't expecting a really clear picture until the new year, once again it's abundantly clear that writers are pushing hard for a correction in Mexican pricing following years of rate declines, especially after such a poor track record of late.

After an all-too-brief spike in rates following Category 3 Hurricane Odile in 2014, prices have declined at a rate of around 10 percent a year, according to anecdotal evidence. The expected response to this is for direct and facultative rates in Mexico to rise by as much as 40 percent on loss-hit accounts, and by a still-hefty 20 percent on loss-free accounts.

As significant as Mexican losses will be, they are only part of a much wider facultative loss picture. Discussions over Puerto Rican renewals will also be crucial, given that the island has a large pharmaceutical industry, having made a concerted effort to entice companies to locate production facilities there in recent years, with players such as Bayer and Merck among the important manufacturing names. Other significant losses to the fac market will come from hotels, especially those on the waterfront resorts, which are more likely to have major claims.

Mexico quake – industry loss estimates ($bn)

Company	Range	Midpoint/ Total	Notes
AIR Worldwide	0.79-1.13	0.96	Estimate relates to Chiapas quake on 7 September only
AIR Worldwide	0.74-2.10	1.42	Estimate relates to Puebla quake on 19 September only
ERN International	na	4.8	Estimate relates to Puebla quake on 19 September only
RMS	na	1.2	Estimate relates to Puebla quake on 19 September only

Source: *Inside FAC*, Company announcements as 13 December

California wildfires – industry loss estimates ($bn)

Company/ Organisation	Range	Midpoint/ Total	Notes
AIR Worldwide	8.0-10.5	9.25	AIR previously estimated losses at $2bn-$3bn from the Tubbs, Pocket, Nuns, Atlas, Redwood and Sulphur fires
California Department of Insurance	na	9.4	California Insurance Commissioner Dave Jones said 260 insurers had reported claims in excess of $9.4bn, as of 1 December
Moody's	na	4.6	Moody's estimated total insured losses to date of $4.6bn, based on 5,700 structures destroyed as of 14 October
PCS	na	7.3	
RMS	6.0-8.0	7	RMS increased its estimate to $6bn-$8bn in late October, following its mid-October estimate of $3bn-$6bn

Source: *Inside FAC*, Company announcements, as of 13 December

Casualty creep?

A key question in all of this is the extent to which the wider fac market will see rate increases in the coming weeks and months.

Here there is a great deal of uncertainty, though the word on the fac grapevine seems to be that at the very least some sort of correction will take place. So for local markets in Singapore, for example, the hope is for stabilisation of pricing after years of rating attrition.

And beyond property? Again, much depends on geography. According to Rich Macrane, managing director for facultative at Willis North America, the series of Q3 cats has not turned out to be all that significant for mainland US casualty fac pricing: "I don't think the storms had any impact as the casualty rates were already starting to turn upwards slightly prior to the recent events. This is the case especially in the wheels segment."

However, other writers in the casualty space do detect an impact from HIM, with one suggesting there has been a tightening of terms and reduction in capacity pretty much across the board for his class.

Public pronouncements also support such sentiments. XL Group noted it is already seeing "double-digit" rate rises for short-tail lines, with loss-affected accounts showing higher increases, according to Greg Hendrick, president of property and casualty insurance and reinsurance.

Speaking on an analyst conference call in the wake of the group's third quarter results, Hendrick noted: "For the longer-tail lines, these businesses will also need to deliver improved margins, and we are expecting rate declines in the aggregate to end."

He also suggested that the spread of rating increases would not be limited to particular lines: "[Given] the reality of a challenging rate environment for a prolonged period with increasing return expectations from underwriting capital providers, we believe that all lines will be impacted from a pricing and terms and conditions perspective."

Still, it remains to be seen just how far the casualty fac side of the market will be able to respond meaningfully to such increases, with old wags suggesting we shouldn't hold our breath just yet. And with a great deal of third party capital still sitting on the touchline, no-one is being complacent.

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PUNCHING ABOVE THEIR WEIGHT

Catrin Shi meets with the co-founders and senior management team of Lloyd's carrier Barbican as they reflect on the company's first 10 years of operation

It's taken something of a Herculean effort to get Barbican CEO David Reeves, chief underwriting officer Mark Harrington and chief operating officer John Godfray in the same room at the same time for their interview with this magazine.

The trio are almost constantly on the move, visiting clients and prospective partners in all corners of the globe.

Because these days, Barbican is far more than just a London market business.

The Lloyd's carrier is celebrating its 10th anniversary this year, having launched in 2007 with a stamp capacity of just £75mn.

Today, the group manages around £500mn in gross written premium and boasts a growing fee business, as well as a well-respected Lloyd's syndicate. During its lifetime, it has strived to bring diversity of capital to the London market, from both traditional and alternative sources.

Now, it has set its sights on the US with a new excess and surplus lines (E&S) property MGA – but Barbican's ambitions do not stop there.

CEO Reeves envisages his firm will continue on its path to eventually become a £1bn premium business – but by organic means only.

Insider Quarterly (*IQ*) sat down with Reeves and his colleagues to find out how.

***IQ*: It's been 10 years since Barbican launched. How different does the company look now to how it was then?**

David Reeves: We launched as a Lloyd's business and are eternally grateful to Lloyd's for giving us that opportunity. We have been able to use our Lloyd's platform as the basis to expand into a much wider insurance group. Back then I thought 2008 was a tough market, but if only we had known how bad it could get!

I think we have real survival characteristics as a business. Our people are tough, experienced, and we have shown we can go through the whole cycle and come out the other end in good shape. We have made a big investment in people, processes and systems to make us tough and sustainable, and to take us through the next 10 years and beyond.

L-R: Jon Godfray, group COO; David Reeves, group CEO; Mark Harrington, group CUO

Mark Harrington: We've deliberately introduced a fee-based part of our business to help us manage the underwriting cycle, so that is a positive development we didn't anticipate at the time.

David Reeves: We believe that within three years' time, our fee income businesses could cover the whole of our group expense, so this has become a very big part of what we do.

John Godfray: Some opportunities have been born out of circumstance and we have evolved in response to market conditions. However, the underlying principles that we built the company on have remained the same throughout. Whilst we have seen significant expansion in our headcount, geographical reach and capacity under management, the organisational DNA, drive and ambition feel very similar to 10 years ago.

***IQ*: What has been the company's greatest achievement in those 10 years?**

David Reeves: Two things stand out. First, the people we have recruited. We have a team which has stayed together through thick and thin. Second, the customers we have and the bigger corporate partnerships we have been lucky enough to land. We don't try to sell hard, we just tell potential partners about our market, how it works, and what we do. We have found that way of educating people about London is the most effective way of building long-term partnerships.

Mark Harrington: An obvious one for me is setting up our Lloyd's managing agency, BMAL – and we did that within three years of launch. That is still one of the best things we have done.

John Godfray: I think that a real differentiator for us is our strong track record and reputation for establishing, and in some cases pioneering, ways of leveraging our expertise for underwriting, capital and syndicate management in return for fee income.

This balance of risk-based and fee-earning income not only allows us to manage our bottom line throughout all stages of the underwriting cycle, but is also a positive for the market in creating a conduit for attractive business that may not otherwise have made its way into London.

> I think we have real survival characteristics as a business. Our people are tough, experienced, and we have shown we can go through the whole cycle and come out the other end in good shape – *David Reeves*

***IQ*: What has been the biggest challenge for Barbican?**

David Reeves: It's really about relevance and how we stay in the brokers' eye, because we are not one of the largest companies in the Lloyd's market.

Another challenge is that we are a self-sufficient company – we're not owned by a major insurance group and don't have a parent to come and help us when times are hard. We are out there on our own.

We have a very solid investor in Texas but we run our own business, so the biggest challenge is doing this all ourselves – we have done it with our bare hands. It's a great challenge to have and if anyone ever gets that opportunity, I would recommend seizing it.

Mark Harrington: I think we are genuinely regarded as being able to punch above our weight. As an independent business, with effectively a Lloyd's-only platform for taking risk, we have managed to keep up our profile and franchise pretty well over the years.

John Godfray: One of the challenges that I think we have managed very well for a company of our size is making bold choices. We have been very agile in expanding our focus, exploring emerging opportunities and investing in new processes and capabilities to keep pace with the demands of our clients and brokers. That has required us to take a number of risks over the years, but in the majority of cases these have paid off.

***IQ*: You have established a track record of successfully sponsoring sidecar syndicates – is this something we can expect more of from Barbican?**

David Reeves: Lloyd's is a tough place to get into. For people who don't know Lloyd's very well, we help explain the opportunities and tailor something to their exact needs. That worked very well with companies like Credit Suisse, which may not previously have had a complete understanding of how the Lloyd's market operates.

The establishment of Special Purpose Arrangement (SPA) 6132 with Toa Re has been a five-year journey of exchanging ideas. We are speaking to many people in many diverse territories to tell them what we do here in London and see if it is of interest. There are about six or eight organisations that are in that dialogue with us, but I don't know which company will be next.

Mark Harrington: We are interested in true partnerships where we can add value but also add something different to our portfolio. Where possible, it is great to bring something to the Lloyd's market that is not there at the moment. We are looking for almost a joint venture-type relationship with them. We rarely engage with what we call opportunistic underwriting capacity.

***IQ*: Tell us a bit more about your new venture in the US.**

Mark Harrington: The platform

Continued on page 32

that we are developing in the US is effectively a start-up MGA business, which in the first instance will specialise in property E&S. With all the recent catastrophe activity, we think our timing may well be perfect for Colin Mayo and his team to get back in the market.

The plan is to write $20mn of premium in year one with a focus on wind-exposed territories in the US, so very much a local US E&S play. I hope from the development of the property E&S part of the business that we can build on this in the same way we have with Barbican Protect and Castel.

IQ: Do you think we will look back at the Q3 2017 cat losses and see them as a turning point in recent market history?

Mark Harrington: Yes. I think that we all recognise there is a significant amount of capital in the market, but we do believe that, coupled with the generally lower margins, recent events will provide the final shove to make people recognise there needs to be an improvement in rates. And it's not just the underwriters, the brokers are accepting that outlook too.

We expect that the more affected lines will see strong rate increases – 20-30 percent on property cat, for example. For the casualty market, which is less affected, we anticipate a positive rate movement of up to 5 percent.

We are trying to get everyone to think about moving the portfolio price in a positive direction, whatever area of business you are in. We have to remain mindful of the individual risk characteristics though, and not to throw the baby out with the bath water.

Experienced underwriters will be able to differentiate between the portfolio rate changes we are looking for and the realistic rate changes for each individual risk.

IQ: How is Barbican positioned to take advantage of any rate increases which may occur as a result of these losses?

Mark Harrington: We have been conservative about our position on cat risk over the course of the last five years and have reduced our exposure as margins have gone down. Now we can aim to increase our position, for example with our new property E&S business, where we expect substantial rate increases.

Although I would hesitate to call this growth opportunistic, we always plan for all eventualities. It is opportunistic from a timing perspective but not a strategic one.

IQ: There are fears the Lloyd's and London market is losing its competitive edge. What do you think the market can do to maintain its global status?

David Reeves: One frequent criticism is that it's too expensive to do business in London. But the fact is there is a cost for strong regulation, and I think we should turn that into a selling advantage, because the triple layer of regulation is very attractive for people coming to London for reliable insurance. They trust the way things are done. The products are hygienic and long lasting, and that comes at a price.

Of course, at the same time, you should always be looking to do things more efficiently in your business. It's a perpetual balance.

John Godfray: The market is not complacent. There is a lot of investment and work underway across Lloyd's and the London market to enhance market efficiency, streamline processes and improve cost management. We need to be receptive and responsive to change.

As an industry, we're getting better at adapting to market conditions but we've got to work even faster and perform better. Harnessing data and technology will have a major part to play in maintaining our competitive edge.

Mark Harrington: I think the attractiveness of London is actually the people that are here. There is real strength and depth across the London market, which is genuinely unrivalled by any other global centre. I think it will take a lot to destabilise that.

IQ: Where would you like to see Barbican in another 10 years' time?

David Reeves: I want to see Barbican at least double in size. At some point during the next 10 years we expect to go through that milestone and have over £1bn of premium under our management.

We are not looking to get there via acquisitions. Our key characteristic is creating new underwriting platforms. We are not out in the market with a big chequebook. By creating and growing successful underwriting platforms such as syndicates, MGA, SPAs, we will get there.

John Godfray: We've never shied away from new challenges or opportunities and I don't see that changing. We see ourselves as early adopters and I would hope that over the next decade we'll continue to be at the forefront of advancing new technologies, innovations and data modelling.

IQ: How do you think the London market will have changed by then?

David Reeves: I think if we stick to our core strengths, the future is bright for the market. Balance sheets are strong, liquidity is high and capability is there. If we can harness the intellectual capital, we will be a much bigger market with a wider global reach. I am an optimist, and I see things coming together well.

Mark Harrington: If I could wish for something, it would be that the industry will manage to make better use of the data that is accumulating. There is significant cost in the chain at the moment.

John Godfray: I think we'll see more market collaboration on common areas of process efficiency. The world is changing at a rapid rate and, rather than fear disruption, we need to work with technology leaders to ensure that we keep pace.

FOUR YEARS OF GOOD LUCK

Normalised return on equity has been significantly below the cost of capital since 2013, so while reinsurers have benefited from good luck, they've also been destroying value, says **Keith Wolfe**

Things aren't always what they seem, which is an understatement when one considers the overall health of the reinsurance sector.

The good luck we had with natural catastrophes is over and it's forcing the industry to acknowledge that things are in a state of disrepair or, at the very least, disarray.

A glance at reinsurers' reported returns on equity since 2012 wouldn't seem like cause for alarm – they were in the 10-15 percent range – but that's dangerously misleading.

When all factors are taken into consideration, normalised returns were well under 10 percent in each of those years – which is a problem, since that level of return is lower than the average cost of capital.

Until recently, good performance in property markets was masking a lot of underlying issues. Companies, in many cases, made money because they were lucky; the catastrophes didn't happen.

In reality, the industry wasn't properly rating coverage for catastrophes during this benign period, and now those inadequate decisions have come full circle as Harvey, Irma and California wildfires prompt serious reconsideration of loss projections.

The warning signs have been present for some time: low-severity cat years, a challenging auto market and low interest rates. Unwillingness to heed these signals and their implications is like harbouring false hope. It's been too easy to ignore the signals when capital is abundant. The cost of capital has decreased every year since 2014 because smart investors know a good thing when they see it. They'll place generous bets in a low-frequency cat period, which can leave (re)insurers feeling satisfied with the status quo for pricing.

Global capital and a steady flow of money into the reinsurance and insurance sectors have created an environment where insurance companies could pay less for their reinsurance and therefore sell their own products for lower prices as well.

Nobody's immune when the global capital base is challenged like it has been this year. Everyone along the value chain is part of the equation.

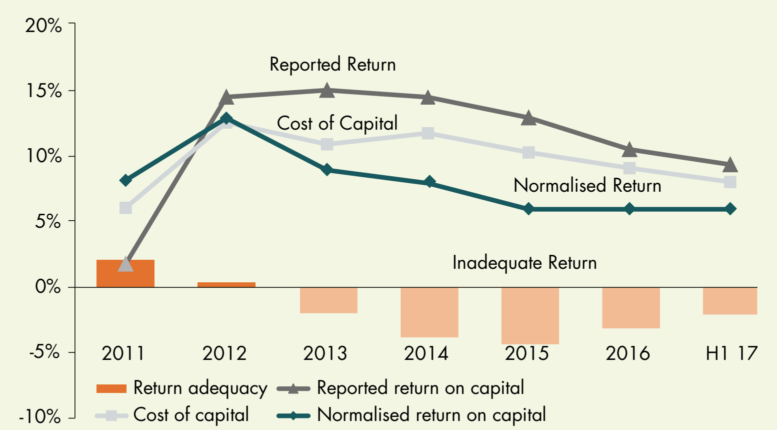
Insurance companies would be well advised to review their buying behaviours over the last several years – and consider the partnerships they've had with reinsurers and address what inevitable economic pressures and changes to the capital base might mean for them.

At Swiss Re, we envision a more resilient world and our mission is to help make it so. But in order to be successful, we need to examine our own fundamentals and make sure we're sound for the long haul, or else that resiliency will be elusive.

KEITH WOLFE is president of US P&C – Regional & National, at Swiss Re

Normalised returns

Lack of large catastrophe activity gives the illusion of sufficient return



Return on equity adjusted for a normal level of catastrophe activity has been significantly below the cost of capital since 2013; essentially, reinsurers' reported results have benefited from good luck while destroying value for the last four years. Source: Swiss Re

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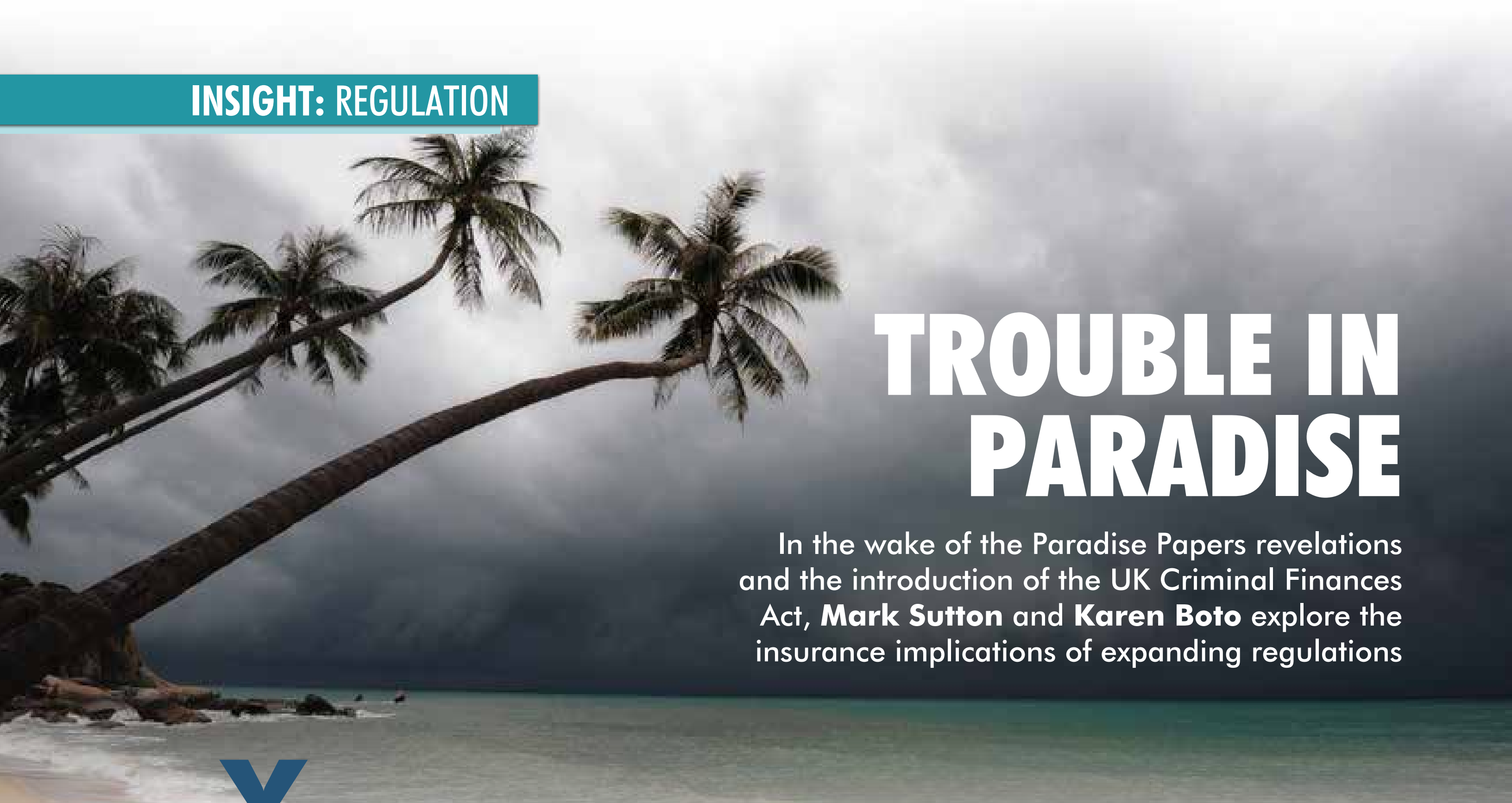

TROUBLE IN PARADISE

In the wake of the Paradise Papers revelations and the introduction of the UK Criminal Finances Act, **Mark Sutton** and **Karen Boto** explore the insurance implications of expanding regulations

Yet again tax avoidance is making headline news. The latest scandal, the so-called Paradise Papers, saw over 13.4 million documents leaked to the German media. These leaks are revealing the offshore investment arrangements of corporate entities and the rich and famous. They are also putting increasing pressure on governments to increase their regulatory powers to force companies to review their business practices.

The Criminal Finances Act

The UK government is strongly attuned to changing public expectations regarding corporate behaviour, and indeed the UK Criminal Finances Act 2017 came into law on 30 September just before this latest incident.

The key change introduced by the act is that it enables companies and partnerships, as well as individuals, to be held accountable for incidents of tax evasion.

The act introduces two new corporate criminal offences, namely the failure of a corporate body to prevent the facilitation of both UK and overseas tax evasion by an "associated person" – an employee, agent or any other person performing services for or on behalf of the corporate body.

This in turn forces directors and officers (D&Os) to maintain better control of their businesses' conduct, wherever in the world they operate.

Before the new act, it was very difficult to hold a corporate body liable for tax evasion – a notable example being HSBC's Swiss banking arm, which allegedly helped wealthy clients to evade taxes but was never called to account by the City regulator.

Under the new legislation, corporate bodies will be required to establish appropriate procedures to prevent any personnel or agents operating on their behalf from deliberately facilitating criminal tax evasion.

The penalties that can be brought against a corporate body found to have committed one of these new offences are tough. They include an unlimited financial penalty and possibly ancillary orders, including confiscation orders or serious crime prevention orders.

In addition, the conviction will be on public record, so if the media furore surrounding the Paradise Papers is any indication of the national mood (where the important distinction between legal avoidance and evasion is often blurred) the company will also suffer considerable reputational damage.

A successful prosecution may also prevent a business from bidding for public contracts.

The new offences apply to all UK companies and partnerships no matter what size, and are modelled on the "failure to prevent" bribery offence contained in the Bribery Act 2010.

Like the Bribery Act, the new Criminal Finance Act imposes "strict liability", which means there is no requirement to prove involvement of the "directing mind" of the corporate body. This approach is designed to overcome the previous difficulties encountered when trying to bring businesses to account for corporate offences.

For a company to be found liable three elements of the offence must be established:

- Criminal evasion of tax by a taxpayer (either an individual or a firm)
- Criminal facilitation of the tax evasion by an associated person of the relevant corporate body, acting in that capacity.
- Failure by the corporate body in preventing the associated person from facilitating the criminal act.

A complete statutory defence is

available to corporate bodies alleged to have committed one of the facilitation offences, if they can show that they implemented reasonable preventative procedures (expected in the circumstances) or where it would have been unreasonable or unrealistic, in the circumstances, to have expected such procedures to be implemented.

What should businesses do?

The onus is on the owners and senior managers of a company to put the appropriate prevention and detection measures in place. The new offences will therefore create the need for further internal investigations to be conducted by large companies to ensure that appropriate measures are in place, which might also encourage both whistleblowing and self-reporting.

This creates a heightened risk of claims being brought against D&Os who may be in breach of their duties to the corporate body if it is determined that the procedures they have in place are inadequate.

The new act also permits the use of deferred prosecution agreements (DPAs), which are a discretionary tool enabling prosecutors to potentially allow culpable companies to avoid a criminal conviction and receive a reduced fine if the corporate body admits any wrongdoing and cooperates, to the satisfaction of the prosecutor and the court.

Although going down the DPA route would spare the guilty corporate body a conviction, one concern is that often the DPA will involve the corporate agreeing to assist and cooperate with the prosecutor's ongoing investigation into particular individuals, which could lead to a greater number of requests for costs indemnity under D&O policies.

The evidence and cooperation obtained from a DPA are also likely to increase the number of convictions against directors. Last month we saw this in action with the former executives of Rolls Royce pleading guilty to bribery and corruption of foreign government officials.

This action may have been influenced by the significant DPAs that Rolls Royce entered into with various regulators.

Implications for insurers

In response to this situation, insurers may want to review their policy wordings to exclude liability for claims that arise out of an approved DPA, in order to avoid paying costs upfront and then having to claw them back post-conviction.

> The Paradise Papers leaks are putting increasing pressure on governments to increase their regulatory powers to force companies to review their business practices

Insurers may also want to consider reviewing the criminal conduct and (given the potential for claims brought by the company against directors) insured versus insured exclusions in their policy wordings.

MARK SUTTON is a partner at Clyde & Co

KAREN BOTO is legal director at Clyde & Co

In particular, brokers and insureds may expressly seek confirmation that cover is extended to this new legislation, as they did following the introduction of the Bribery Act.

Internal investigation costs will be another key consideration for insurers as the new offences will increase the need to conduct complex internal enquiries.

D&O insurers may want to review their policies to see if they will be expected to meet the costs of any such investigation, before a prosecution is initiated. They also might want to consider if they are prepared to provide cover for these investigations for the corporate entity as well as the individual D&Os.

Watch this space

The risk of corporate prosecution is only going to rise. The introduction of the Criminal Finances Act will undoubtedly make it easier to prosecute corporate bodies in relation to tax evasion offences. The recent decision in *Ivey v Genting Casinos*, which changed the criminal test for dishonesty and is widely tipped to make it easier to prosecute tax evasion facilitation offences, will also lower the bar.

More broadly, this change comes at a time when corporates are readying themselves for the introduction in May 2018 of the general data protection regulations (GDPR), which will bring cyber risk and the management of sensitive data to the forefront of the risk landscape for companies both in the UK and across the EU, further increasing exposures for D&Os.

For financial services and market authority-approved firms, the scrutiny will be unprecedented as they get to grips with the extension of the Senior Managers and Certification Regime to all authorised firms in 2018.

This means that D&Os and their insurers and brokers will need to stay alert, particularly as the government looks set to tighten corporate governance further with the suggestion that more "failure to prevent" offences for other forms of economic crime may be introduced soon.

With this changing regulatory environment in mind, insurers may wish to review the breadth of their D&O policy cover. Over the past few years they may well have seen their wording "creep" in response to intense competition in the market.

Brokers should also be alert to the current situation and ensure that insureds have the appropriate insurance protection in place.

Could the perfect storm of new revelations of potential tax avoidance on an unprecedented scale, changing public attitudes to corporate governance and more onerous regulation be the trigger that finally turns the D&O market? All we can say is "watch this space".

WHITE HEAT

London is a crucible for innovation, writes **Toby Esser**, and now is the time to forge new business opportunities by exploring InsurTech

There is a feeling of change in the air, and it isn't tied to the inevitable shift of autumn into winter. No, this is something different, something molten, difficult to isolate – and happening as you read this.

From embracing new types of risk to introducing flexible ways of working, exploring modern technology and harnessing the power of networks to compete with giants, ideas are smelting in the crucible of the London market.

From the ground up

Some, especially those outside the industry, may still think that the future of insurance is an endless repeating pattern of grey suits working unrelentingly from 08:00 to 18:00 within a strict, linear hierarchy.

Not a bit of it. The traditional, drab image of most businesses connected with insurance or financial services is being replaced with bold, bright colours and ideas such as hot desking and flexible working hours. In particular, the hallmark of the most modern independent brokers and underwriters is valuing the ideas of all employees, no matter their seniority.

This is a market which must attract and retain new talent, and the best companies will proactively identify and propel the most dynamic young minds into senior positions more quickly than at any time in the past. The next generation, with their fresh thoughts and ideas, need to be given the opportunity to prove their worth.

Accelerating InsurTech

This fresh thinking should be closely linked to actively seeking out InsurTech ideas and start-up businesses, and accelerating them to drive change at a market level. We shouldn't sit around watching technology start-ups struggle to get off the ground, while simultaneously complaining about slow progress in the sector.

It's no secret that the insurance industry needs to modernise, both in terms of its attractiveness to new talent and its actual processes, which are still archaic beyond belief in some areas.

For instance, while there may be good reasons why some classes of business are not currently electronically placed, there is absolutely no reason why all classes of insurance business should not be electronically processed.

Supporting the latest and best ideas will disrupt the traditional business model in favour of more agile, proactive ways of working. But InsurTech start-ups require access to private, corporate and institutional funding, as well as the expertise and insights that broker and carrier partners can offer.

It is all very well saying InsurTech start-ups need the backing and practical support of the industry, but only a few are prepared to lead by example and integrate new technology into their own processes first.

This is where young, independent brokers come into their own – the absence of legacy issues makes these businesses much more agile and open to adopting and quickly integrating new ways of working, unlike their larger, more unwieldy competitors.

This is certainly not to say the market will move away from being relationship-driven, rather that the best technology enables more face-to-face meetings to cover what truly matters, while offering more efficient and effective underlying processes to support every aspect of that relationship.

New areas of risk

Change is also coming to the way the market looks at risk, particularly new areas of risk.

Traditional insurance has tended to work from the "product first" perspective, where an off-the-shelf product is pushed towards a client as part of a "one-size-fits-all" approach.

But innovators in the market have been flipping this approach on its head and have instead focused fully on the client, taking the time to sit down with them and listen to what they are looking for from their insurance products. Such innovators are then working back through the market with forward-thinking Lloyd's underwriters to create a truly bespoke solution.

A more open-minded approach from underwriters is still required. Take, for instance, the peer-to-peer and sharing economy sector, where there is a real need for the insurance industry, and insurance market associations, to wake up and find innovative solutions for areas of uninsured risk.

As the furore over taxi-hailing technology firm Uber's licence to operate in London recently demonstrated, sharing economy initiatives must keep pace with regulation and insurance, and vice versa. Sharing economy and peer-to-peer business models are disrupting traditional models around the world, and represent an area of uncovered risk that the (re)insurance market needs to wake up to.

The short-term letting market is another example of a new peer-to-peer model which has shown huge growth in the last two years, but the sector is now being held back by the slow pace of recognition from some areas of the insurance industry.

This is a new frontier for insurance, and there is great potential for innovation, including developing on-demand premiums, streamlined policy access and much more. But unless the insurance industry works together to recognise and properly service rising consumer demand, it risks not only hindering progress in the peer-to-peer model, but also missing out on the enormous opportunities offered by modern economies.

> It is all very well saying InsurTech start-ups need the backing and practical support of the industry, but only a few are prepared to lead by example and integrate new technology into their own processes first

TOBY ESSER is executive chairman of AFL Insurance Brokers

Independent growth

Expanding into new and existing areas of risk involves growth, both organically and through acquisitions. But realistically, it is a huge challenge for a smaller, independent broker to reach the required critical mass to compete with the international broking behemoths, and their wholly owned global networks.

However, change is coming to this model too. For instance, on the retail side, the large international players can be proficient in servicing multinational clients in some core countries, but they can also let these clients down with poorly performing local offices elsewhere.

This is an opportunity for non-owned network models, which involve independent brokers around the world collaborating to service multinational clients, to come into their own. The Worldwide Broker Network is the largest of these non-owned networks of independent brokers, collectively handling premiums in excess of £50bn ($65.54bn).

There is strength in numbers, but also the advantage that each individual broker is incentivised to give the best possible personal and bespoke service in their region, offering multinational retail clients a real alternative to the one-size-fits-all approach on the table elsewhere.

Competitive edge

The big brokers try to be all things to all people, but this isn't necessarily a sustainable strategy. On the wholesale side, choice is also key, but here consolidation is limiting choice for insurance buyers. Indeed, the UK broker consolidation wave continues to roll, driven by relatively cheap debt, historically low interest rates and interest from private equity backers.

However, having been involved in 11 M&A processes in the UK over the last year, I can say that pricing is the highest I've seen in 25 years – and this concerns me because I feel bidders don't properly take into account exchange rate impacts, particularly considering the US dollar revenue and sterling expense setup of a typical UK broker.

To be successful in the future, brokers must be at the forefront of all the changes to distribution norms that new technology is enabling. The best will have the flexibility to quickly adapt and navigate uncertain landscapes where cumbersome business models may stall.

The key ingredient of course is commercial viability. Whatever the initiative, it must offer a competitive edge to the backer, as well as benefits for the end user, client or employee. New ideas must be able to withstand the fierce heat of competition, and emerge stronger than the sum of their parts.

REFLECTING ON CLAIMS

Cumbersome processes and settlement delays are reflecting badly on Lloyd's reputation for paying claims, as well impacting coverholders' standing in their domestic markets, says **Sarah Newman**

Sometimes we can get so wrapped up in the internal workings of the spectacular machine that is the Lloyd's insurance market that we forget how we appear to those outside this specialist global hub – or even to those on its periphery.

Simple market-led mechanisms such as premium price hardening in the wake of catastrophic events can easily be interpreted by the wider world as unfair, even underhand, machinations – just another insurance complot designed cynically to kick those that are down, and price the uninsured out of the market.

The industry also suffers from the perception in the public consciousness that complex wordings and exclusions are designed to impede claims payments.

The suspicion is that insurers will either point to the small print and refuse to pay a claim, or drag their feet and pay valid claims only belatedly and reluctantly.

This perception is not improved by the fact that, earlier this year, a new law came into force in the UK, under the Enterprise Act granting insureds the right to claim damages if undisputed claims are paid late. The law, which applies to all (re)insurance contracts, stipulates payment within a "reasonable time" – the first time that the issue of late claims payments had been tackled with penalties in this way.

The fact that this law was deemed necessary says a lot about the industry's track record.

A claim is a promise

Swift payment of all valid claims should be the central role of any insurance business – lose focus on this and you risk damaging not only your own business's reputation, but that of the whole industry. It's an issue of trust, which isn't helped when claims disputes (such as Kanye West's ongoing tussle with Lloyd's over a tour cancellation) hit mainstream headlines around the world.

Rightly or wrongly, news that a claim is being disputed will inevitably feed public perceptions about the industry.

It's time to hold a mirror up to this market. We all need to work harder to make sure valid claims are paid swiftly and efficiently.

Take the coverholder model, for instance. Coverholders are a proven and successful way of placing business with Lloyd's, offering benefits to each of the parties involved and increasing the volume of business, from the US and Canada in particular, flowing into Lloyd's.

But in the past Lloyd's coverholders have complained of cumbersome and onerous processes for extracting claims from the market. These include inefficiencies and delays

Continued on page **42**

connected with duplication, regulatory compliance, use of multiple platforms, and an overall lack of transparency and accountability.

> It's time to hold a mirror up to this market. We all need to work harder to make sure valid claims are paid swiftly and efficiently

Mirror on the market

Delays in paying claims can obviously have a reputational impact on a coverholder in its domestic market.

A Canadian coverholder we work with voiced the views and experiences of many, telling us that Lloyd's generally responds slower than subscribing domestic markets, regularly leading to a situation where they have funds from every other market to settle a loss, except Lloyd's.

This is not aided by some of the existing systems and processes that we continue to persevere with, which ultimately create something of a bottleneck for business.

Our clients are calling on the London market to empower coverholders and provide them with resources to propel the Lloyd's brand into a position of high esteem; rather than the current situation of coverholders having to explain delays due to an old-fashioned business model or process.

Challenges also persist relating to ever-increasing compliance and regulations, which require Lloyd's coverholders to spend an inordinate amount of work and time implementing procedures necessary to satisfy Lloyd's requirements and pass audits.

Of course, there are clear benefits to being a Lloyd's coverholder, not least the fact that it provides access to a flexible business model that allows them to secure business within the broker channel, which other non-coverholder domestic rivals may not have access to.

However, the current issue of Brexit should bring challenges like slow claims payments to international coverholders into even sharper relief.

Now, more than ever, the London market must protect and increase its competitive edge in the international market or risk coverholders simply getting fed up and refocusing elsewhere.

SARAH NEWMAN is support services director at Endeavour Insurance Services

New technology

Work to streamline London market claims payments is progressing of course, and it has been for years. For instance, the London Market Association says it is undertaking some "exploratory work looking into the feasibility" of introducing automated learning/robotics technology.

These are carefully chosen words, but clearly there is promise here: such technology has the potential to support and enhance the roles of claims handlers and managers.

However, delegated authority claims must be handled more efficiently right now in order to prevent loss of business. Systems are needed today, yesterday even, that empower coverholders to more effectively exercise the authority given to them.

It is essential that new systems enhance the notification and communication of claims during the life cycle, improving the message and notification to brokers and customers.

We also firmly believe brokers have a role to play, but it's not the one they've been playing in bygone years. With increasing costs, compliance restrictions and actuaries scrutinising business plans, it is inevitable that the basis for remuneration and how that is apportioned will be reviewed. There is pressure on brokers, in particular, to demonstrate that the role they are undertaking adds value to the process.

For this reason, the model that we have embraced provides a single, unified platform that allows coverholders, brokers and the market to keep sight of claims with complete transparency.

All information is stored in one central location, whilst providing the capability to interface with market systems such as Lineage and ECF, and other parties' internal systems. Crucially, Endeavour clients can use the system free of charge.

There are other models out there too, of course, and ultimately the entire market needs to work together to cut out inefficiencies in claims processing.

This in turn would allow valuable resources to be refocused and redistributed to client-facing work, improving both the client experience and the experience of the claims handler, whose job would become more dynamic since they would no longer need to laboriously re-enter data for claim after claim while slowly slumping their head against their keyboard.

Retaining claims talent

Making the claims process more efficient – and the job more absorbing – could even improve staff retention. There is a large pool of talent in the claims community, but we risk seeing more and more claims professionals leave the market unless we modernise, and this means supporting them with the tools and technology that allow them to swiftly deliver what insureds were promised.

Lloyd's success has been built on its reputation for paying all valid claims. The aftermath of the 1906 San Francisco earthquake is testament to this.

In fact, to many clients, the claims service is one of the most influential factors when choosing a product from a (re)insurer.

We simply don't have time to wait for more months and years of testing – delays in paying valid coverholder claims are reflecting poorly on the market today.

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STORY TIME

Technology is driving the claims process, but the real story, says Mark Grocott, is about knowing customers' needs and using technology to respond to them more effectively

We all tell stories. They begin, as often as not, where questions arise and a decision has to be made. What will I do if I win the lottery? Where will my business be in five years' time?

A story provides the framework that embeds choices in actions that have a past, a present and a (still uncertain) future. And, in business, one of the greatest driving forces behind the stories we tell ourselves these days is the pace of technological change.

Clearly brokers, insurers and all those involved in service delivery to the insurance industry need to embrace technology, particularly to support those customers who themselves embrace technology, in order to remain relevant in today's market.

Technology can, when deployed correctly, improve our processes, speed up our business flow, add value and shorten the distribution chain. But how specifically should we use technology to respond to our customers' expectations?

A new narrative

In the aftermath of an escape of water, for instance, policyholders demand action. The small food processing company with a business interruption claim is primarily concerned with getting the business back on track as quickly as possible. The homeowner doesn't want his or her family spending months in temporary accommodation. Yet, every year after a flood, we hear complaints that the insurance industry is lacking in urgency and empathy.

Technology, closely married to customer service skills and great processes, can play a big part in alleviating this frustration. But there are big decisions to be made.

At Davies we've established beyond all reasonable doubt that when it comes to claims a single platform is the best way to provide the desired insight into the customer experience, as well as the ability to feed seamlessly into major clients' and providers' own systems.

It helps us support the customer, make decisions more quickly and identify fraud patterns. And all that data can be used to develop more sophisticated claim strategies with insurers and reinsurers.

But that's just the beginning of the story (since all stories have a beginning, a middle and an end). The next step is to harness the power of technology to provide smarter service and better outcomes. Here again there are decisions to be made over priorities.

For example, technology can allow us to receive input data just once and analyse it on the spot. Or we can overlay new data sets with our claims data to help us identify fraud potential more accurately. Or use analytics to help our clients with their own risk management strategies.

Finding the plot

The way we use technology is critical. Consider the motor claims market, which in a typically risk-averse space has been in the vanguard of technology, empowering claims handlers to make virtually real-time decisions.

At Davies we use a lot of online video evidence provided by policyholders – and this has now been widely extended to property claims too. But it's not a silver bullet. It works only if backed up by expert handlers who can interpret the evidence and respond to each individual case.

There's a long list of technologies helping to cut claims times. We now regularly use drones to assess property damage in areas where access is difficult. Smartphone technology makes it possible to agree on-the-spot instant variations on works with contractors through video data capture. And the future will bring more and more options. The connected home where all risks are diagnosed, or the smart car that can pinpoint the events leading up to an accident are no longer the imaginings of science fiction.

Connectivity is the future for the implementation of technology in the claims arena. Some claims will be resolved instantly without the insurer's intervention. For instance, facts about a delayed flight will be relayed instantly and the appropriate sum paid directly into the insured traveller's bank account.

But what impact will all this have on the claims culture? What are the legal implications? And, above all, to what extent will the new world support customer choice?

In stressing the importance of choice in the implementation of technological innovation, it is clear there is a wide range of approaches to individual claims and it's our job to select the best solution in each case. Of course, this is particularly true of complex major loss claims where it is essential to get the right technology in the hands of the loss adjuster on the ground.

The human factor

With every choice there's the risk of taking the wrong path. The strategy must be to enhance the overall service with technology and not impair it. Other strategies – such as simply taking out cost through technology – may not in the long run mesh with the client's objectives.

Think of your own experience with, say, internet banking. Most of the time you may be happy with online connectivity without the intervention of any human operator. But there will be times when you long to talk to a real person.

In handling insurance claims we have to be very sensitive to these varying needs. It would be a massive mistake to think that all claims could be settled using artificial intelligence (AI). The secret is to allow technology to carry out the simpler processes, freeing up your team to make the harder decisions and focusing on the more complex concerns of your clients. For instance – in employing measures, such as net promoter score and client satisfaction surveys, to segment the customer base in a way that achieves the best outcome.

If claims administration companies are to play an integral part in the future value chain, it will only be by adapting to clients' needs, both by embracing new technologies and investing in the skills of their people.

Take just two key areas: customer complaints and regulatory services. Innovations for supporting both of these disciplines will come from both technological advance and the intervention of skilled professionals. The reputation of insurance providers will depend on balancing these new solutions to the satisfaction of their clients.

Happy ending

My experience in the claims industry tells me to rely on people because they tell stories better than machines.

The use of technology in claims is only about responding to the needs of the customer. That entails first knowing your customers' needs inside out.

Are they time-poor? Do they need extra support through the claims process? Can you help them to manage their business and reduce risks?

People still answer these questions better than machines, but they need support in collecting and analysing the raw data.

The processes we develop need to be grounded in hard evidence and continuous improvement. That's where AI comes in again, monitoring outcomes – claim costs, complaints, life cycles – through joined-up technology and providing a much faster and more dynamic way of driving improvement and service delivery.

The strategy must be to enhance the overall service with technology and not impair it. Other strategies – such as simply taking out cost through technology – may not in the long run mesh with the client's objectives

We must offer a broad toolkit of options to support customer choice. By adopting technology and automation we will be able to release skilled staff to solve harder problems and implement effective strategies to further improve service.

If we don't take this route and instead opt for an entirely automated approach to claims, then there will be plenty of new entrants into the market – including Google and perhaps Amazon – that have the skills to out-compete us.

It comes down to a never-ending story, based on evolution and renewal, but always dependent on choice.

This is how the poet, Robert Frost sums up the question of choice and deciding:

Two roads diverged in a wood, and I—
I took the one less traveled by,
And that has made all the difference.

MARK GROCOTT is chief digital officer of the Davies Group

UNDER THE MICROSCOPE

Charles Pickles examines asbestos in the workplace and how to manage the risk effectively with reassurance air monitoring

In cases involving potential personal exposure to asbestos fibres in buildings, the need to consider "materially increasing risk" means that the detailed analysis of asbestos fibres provided by scanning electron microscopy (SEM) offers much greater levels of clarity compared to standard techniques.

Even though asbestos has been banned in construction materials since late 1999, and a huge amount removed from buildings over the years, there are still many properties of all types where the decision has been made to leave asbestos-containing materials (ACMs) in situ and manage its presence.

The decision to manage ACMs is not necessarily a bad one as asbestos in good condition can be safe as long as its presence is known about and the material is maintained.

However, for those responsible for maintaining buildings where asbestos is known to be present, the crucial question is how it can be dealt with safely?

The hazard is potentially the presence of asbestos in a building, but the risk to occupants is when the asbestos fibres become airborne and can be inhaled. An asbestos survey identifies the hazard, but on its own rarely identifies the risk present to a meaningful level.

HSE responsibilities

There are strict Health and Safety Executive responsibilities for property owners that are aimed at reducing the risks to health that asbestos poses, and there should no longer be any excuse for anyone being exposed to potentially dangerous levels of airborne asbestos fibres.

The Health and Safety at Work Act 1974 says: "It shall be the duty of every employer to ensure, so far as is reasonably practicable, the health, safety and welfare at work of all employees."

More specifically, the Control of Asbestos Regulations 2012, Regulation 4.8, (Duty to Manage) Asbestos, mandates that a determination of the risk from any asbestos known to be present is made.

Moreover, it says: "The regulation is designed to make sure anyone who carries out any work in non-domestic premises and any occupants of the premises are not exposed to asbestos from ACMs that may be present."

This responsibility falls to the duty holder, who is usually the person or

organisation that has clear responsibility for the maintenance or repair of the premises. The duty holder is required to assess and manage the risks from asbestos to employees and others, and must ensure that anyone who is likely to work on, or disturb, asbestos is provided with information about its location and condition.

Government policy considers that asbestos that remains in good condition and unlikely to be damaged or disturbed is not a significant risk to health as long as it is properly managed. Only when ACMs are disturbed or damaged is the risk of exposure increased through the release of airborne fibres.

Rigorous systems of asbestos management are therefore needed to prevent staff and the public disturbing ACMs that are accessible to them. This involves the careful monitoring and management of building materials at all times.

Regular inspections and checks by the duty holder of the condition of ACMs are essential and this should include details of any precautionary or safeguarding measures that are needed. As part of this requirement an assessment of the risk associated with each identified occurrence of asbestos is required.

Effective risk management

Against a background of growing public concern over the potentially harmful effects of asbestos in buildings, modern air monitoring and analytical techniques now have the capability to detect much lower concentrations of any asbestos fibres present.

This means that the periodic monitoring of air samples is now much more relevant and realistic rather than simply monitoring conditions after building repairs or asbestos removal work.

In particular, a formal programme of reassurance air monitoring using powerful SEM can more effectively measure occupational exposure concentrations for asbestos in workplace premises than other techniques.

SEM enables asbestos in air to be quantified to very low levels, typically achieving lower limits of detection to 0.0005 fibres/cm3 and below, compared to the 0.01 fibres/cm3 capability of standard phase contrast microscopy (PCOM). SEM can also distinguish between different asbestos fibre types and other non-organic fibres.

Current analysis using standard PCOM has a limit of detection that is wholly unsuitable for risk assessment in an occupied environment and is only really valid for asbestos removal monitoring.

> Air monitoring using SEM enables actual and direct asbestos risk measurements to be made in specific building locations. This in turn can be used to prioritise risk and target spending on remedial works

In such circumstances, SEM's ability to more accurately determine whether asbestos fibres are present means it can better identify the level of any risk that might be present – and what remedial actions are required.

Used in this way, air monitoring using SEM enables actual and direct asbestos risk measurements to be made in specific building locations. This in turn can be used to prioritise risk and target spending on remedial works and provide the reassurance that those present in the building are not being exposed to harmful fibre levels.

A future defence

This is particularly important in bolstering any defence against a potential future legal claim where the duty holder will need to demonstrate that the best available practicable technique was used to enable a suitable and sufficient risk assessment to be made.

In particular, the *Fairchild v Glenhaven Funeral Services Ltd (2002)* case specifically identifies that the appropriate test of causation is whether the employer had materially increased the risk of harm to the claimants.

With asbestos fibres there is usually a time interval of decades after any exposure before the onset of disease. For the person responsible in law for the provision of a safe working environment, the prospects of civil litigation arising at some time in the future from a very small contribution to the asbestos exposure of someone who subsequently develops mesothelioma should not be overlooked.

CHARLES PICKLES is chief technical officer of Lucion Services

As a result, if potential liabilities are to be avoided or defended, it will often be necessary to demonstrate that airborne asbestos concentrations did or did not significantly exceed background levels.

To be relevant, the sampling needs to coincide with suitable and representative site activities and conditions – however, the impact of false positives associated with the inclusion in samples of non-asbestos fibres can be considerable.

In such circumstances, PCOM will give only a total fibre concentration rather than an asbestos fibre concentration, so the ability of SEM to discriminate between asbestos and non-asbestos fibres can provide a true reading.

Nobody should be complacent about the health risks associated with asbestos. Workplace air sampling and analysis utilising SEM can ratify the effectiveness of existing asbestos management techniques and prove that asbestos fibres levels are not elevated – providing vital reassurance that anyone present is not being exposed to potentially harmful asbestos fibre levels.

HAPPY BIRTHDAY TO YOU!

Aidan O'Neill celebrates the recent second birthday of the launch of Write-Back, which has enabled London market insurers to interact fully with the market's central claims systems

Where has the time gone? Just over two years ago in July 2015, the Lloyd's Market Association (LMA) in partnership with a handful of managing agent early adopters unleashed its Write-Back operating system onto the world.

Two years on, Write-Back is going stronger than ever. So, let's look back at Write-Back's achievements over the last 24 months, the greatest benefits realised so far from the claims management system, and what lies ahead.

Going live

It's hard to believe that the ground-breaking, message-based technology, which allows the IT systems of London market insurers to interact fully with the market's central claims systems, ECF2, went live only two years ago.

The actual go-live date was Saturday 17 October 2015 and I remember the nerves we felt at Docosoft – one of the software provider midwives present at the birth of Write-Back – as it entered the world.

Write-Back was the result of intensive and successful market collaboration over a period of 18 months between a number of software providers and Lloyd's and London market carriers. The high level of co-operation during the development phase, sponsored and overseen by the Associations' Administration Committee, was followed by 15 weeks of intensive testing, which led to a successful delivery.

Docosoft was responsible for two carriers implementing as early adopters – Faraday and Talbot. The implementation was smooth and within the deadlines that were set, and so began a new era in London market claims transformation for our carrier clients.

At the time, Lee Elliston, the LMA's senior executive, claims, said: "It's hard to overstate the importance of this. Write-Back represents the biggest technological change for claims since ECF was launched in 2006."

Lee's optimism has since been validated by the huge benefits provided by this London market technology innovation success story.

Write-Back benefits

Write-Back now provides market carriers with greater flexibility in managing claims; it removes duplication and inefficiencies, and offers enriched data and management information by providing near real-time claim notification.

The new functionality increases the degree of interaction markedly, letting broker data flow into a carrier's system within seconds, and enables the carrier to build its own "view" of a claim. The carrier can then respond to the claim, sending data back into the market's central systems, enhancing how an electronic claim is handled and managed.

The primary objective was to introduce functionality that offers carriers the ability to review and respond to a claim in their own system which, in turn, would offer flexibility to carriers in managing claims electronically.

The system now provides the following benefits:

- Savings in effort and cost through a single operating model (London and non-London)
- Removal of duplication of effort caused by working across multiple systems
- Reduction in restrictions to central systems working hours
- Insulation from risk of central systems performance issues and unavailability
- Reduction in effort and simplification of claims handling
- Improvements in access to claim data and information

Award-winning technology

Within months of the launch, it was clear that Write Back's market-wide implementation had been a success.

At the end of 2015 the LMA, via ECF Write-Back, was awarded London market "Technology Initiative of the Year" by a publisher I will refrain from mentioning in *Insider Quarterly* magazine, but readers can probably guess which organisation I am referring to!

This followed Write-Back's Business Process Improvement Award for the LMA at Acord's annual conference in Florida the previous month.

That was excellent news at a London market level. And at Docosoft we were delighted to discover that our clients loved the security and ability to work through central systems performance issues and unavailability that other non-Write-Back carriers were – and still are – experiencing.

As word went round the claims community that Write-Back was a winner, more carriers started to come on board.

In June 2016 it was the turn of Markel to go live with Docosoft's Write-Back solution, followed by MAP shortly after in July 2016, and then by Starr and Aegis London. Starr went live in October 2016, while Aegis received an upgrade of its existing Docosoft claims management system (CMS) to the Write-Back iteration in November that year. Then, as of January 2017, all systems were "go" at Axis as it also went live.

I won't bore readers with the full list of Lloyd's managing agents that have adopted the system but, suffice to say, it's a lot!

Competitive advantage

Our experience has been that, typically, an adjuster would have 18 different actions across seven different systems and eight different processes to handle one claim.

With the help of Write-Back we were able to combine a large proportion of those processes into a single system. Claims handlers can now do their job in real time so they are recording quality claims data that we can use for analysis, performance measurement and for freeing up time for other customer service-focused requirements.

The five key steps to competitive advantage that the claims management system can provide include:

- Up to 50 percent reduction in claims handling turnaround time
- Estimated £350,000 saved for a small team of claims handlers
- 625 days saved, based on 30,000 claims processed a year
- 10 minutes minimum saved per claim
- 24/7 access claim response ability

There has been impressive market-wide take-up of the technology. Twelve market carriers are now live on the Docosoft Write-Back CMS – close to 25 percent of Lloyd's managing agents.

The plaudits have rained in, with one head of claims at a large managing agent telling me that the result is a system that will help them revolutionise the way they handle claims.

Modesty prevents me from divulging the name of the head of claims who said that. But it doesn't stop me from mentioning that our Write-Back-enabled CMS version has now picked up three awards in the last 10 months – a London market technology initiative award, a national Irish Times Fintech Innovation Award and a global Acord Case Study award for Business Process Improvement, which we gratefully received at the annual Acord global conference in Boston in October this year.

An Acord award is a prestigious honour recognised throughout the insurance industry worldwide. These awards are presented to those organisations and individuals who have demonstrated outstanding achievement in implementation in the past year.

The story continues

So, what is the future for Write-Back?

Its capability to deliver enhanced data analytics is certainly very promising. To take advantage of the data insights in an organisation requires new ways of automatically organising, classifying and labelling documents and data. Using advanced machine learning techniques, we believe that the data analytics on our Write-Back-enabled CMS will do just this. The new technology can take hundreds of thousands of claims and policy documents and data as inputs and outputs their hidden thematic structure and relationships, which leads to actionable insights such as improvements in compliance, cost structures and competitiveness.

It will then be possible for this new machine-learning technology to crunch petabytes of data more efficiently and make sense of a complicated claims world.

There is much to look forward to for Write-Back, which is only at the start of its journey.

AIDAN O'NEILL,
CEO, DOCOsoft

INNOVATION AT A SNAIL'S PACE

Standardisation and automation of straight-through data processing will boost regulatory compliance and client satisfaction, but greater engagement is needed to increase the rate of change, says **Malcolm Snow**

When I started work in the insurance industry in the 1980s, laptops, email, mobile phones and even facsimiles were all future technology. When you needed to use a computer, you had to go to a dedicated room; if all were busy you had to wait until someone finished.

Oh, how things have changed! But are they moving fast enough? Faster and new technology seems to be out there, but is it being embraced?

We all know – in fact, I shudder to realise we are still being told – that the market process for submitting risk information on binding authorities is littered with inefficiencies, including significant manual effort and multiple hand-offs between several parties that generate a lot of duplication and rework.

New processes that allow a coverholder to submit risk information electronically, via a common data standard, straight into third party providers' systems and that immediately identify any issues with the bordereaux are indeed available. For anyone working in operations, this kind of straight-through process is the optimal way of working. But it is also not something that is implemented overnight.

Standardisation and automation of market data delivers confidence that the market is meeting its regulatory requirements. Regulation has certainly contributed to the requirement of risk level data for carriers; increased regulation is inevitable, and there will be further pressure on carriers to prove that they are aware of the risks facing them and that they are adequately capitalised. Who knows what Brexit will bring?

The message for change has been echoing its way around the London market for many years, and once again at the quarterly gathering for ACORD members the same message was repeated by Tom Hamill of the Lloyd's Market Association (LMA).

It's a message that is being reinforced time and time again and, although the London market Target Operating Model (TOM) is making progress, it still feels like there is significant resistance to engagement. Workshop attendances do not equate to being "engaged".

The approach feels too carrier-driven. If you look to other providers of successful products and services – e.g. Amazon, Apple etc – they are consumer-orientated.

It could be the issue is the cost of implementing new processes, or that people are simply too busy doing their day jobs to realise what can be achieved. Cost will always be a factor and some vendors will not make system changes they do not have to make unless they are paid.

I personally sat in on several conversations with US vendors when attending a meeting of the American Association of Managing General Agents a couple of years ago, and the question they all asked was "Who is paying for the changes?"

Surely, where the client, coverholder or MGA is sophisticated enough to already deliver data efficiently, we should embrace these and look to adopt a similar model with likeminded organisations, while retaining the less sophisticated organisations, virtually at least, at the table.

My point, therefore, is: "Are we looking to solve the solution in the right area?"

The focus has always been on protecting the London market, but who keeps the London market going?

Is it not, in fact, the many clients who are looking for an insurance product? If we were to concentrate on these clients and not place so much emphasis on looking at solutions for the carrier market, then we may actually achieve something.

This may seem a very blunt statement, but without the client we do not exist. Yes, there are initiatives out there looking at how to make it easier for the client's business to be placed into London, but should we try to understand what the clients currently can and cannot provide before planning, developing and implementing solutions that may in fact make it more difficult and expensive for them.

My involvement with "Project Tomorrow" gave me first-hand experience and insight into some of the challenges the market is trying to solve.

During this initiative the client, and in particular their system provider, played a pivotal role in achieving straight-through processing to the carrier market. Implementing an ACORD standard and levels of data validation culminated in data transfer to the carrier market, where little or no further validation was required. The client was already capturing much of the data to be submitted, it was simply the mechanism of transfer that changed. But these initiatives are not cheap, and the market must remember there are other players – the much more numerous organisations churning away in their particular niche.

Should we understand what data our clients are holding? Many have sophisticated and complex data capture systems and others simply rely on old technology that serves their purpose, but should we know what they capture and hold prior to making decisions on what we wish to receive and how and when we receive it?

I remember a conversation had during Project Tomorrow, where we were looking to change the delivery process from monthly Excel files and looking to receive weekly XML. I questioned why weekly – why should we not receive the data daily or even in real time?

Effectively, I was looking at replacing the current bordereaux cycle with an alternative method of receiving the data.

The validation of the data is critical and it can be carried out prior to any outbound bordereaux being created – thus the carriers and even brokers would receive pre-validated data that should be easily consumed into their systems.

The validation should be rigorous and fit for purpose, based on individual contract specifics. Data quality can slow the process down tremendously after all, and we really do not want query loops.

Educating clients into keying data that is both accurate and correct for the London market is therefore critical.

Working at Morning Data has made me realise that the brokers in the London market really do know their clients and have their part to play in obtaining and transmitting risk level data in a more efficient and effective way.

In some cases, however, they haven't seen a practical method to accomplish this without disrupting the processes of their clients – nor indeed have they the time to implement a solution – so they wait for someone else to provide the answer.

The assumption across the niche smaller broker is that the solution will just arrive. There is invariably no budget to have an in house retained IT team to even look after their own devices, let alone focus on process improvement. The lack of substantive IT knowledge – which in these brokers means the high-level promises of "platforms" and "automation" – is the differentiator between them and the larger broker.

In many cases, the smaller broker handles a disproportionately large amount of risk level data through economies of scale in multiple binder contracts. But should third party binders really still be processed as post boxes in this day and age?

There are Lloyd's brokers that have already taken the necessary steps to automate processes with their clients, receiving electronic data weekly, daily and even in real time. But they are then having to convert this into a monthly Excel spreadsheet for distribution to the carrier market, slowing down the distribution.

At Morning Data, we are already looking at solutions to receive or extract client data and create the necessary outward bordereaux for the carrier market.

The work has already been done to voice the concerns of the SME broker and MGA – to sell the story that more is better when it comes to data, and that aggregating up is easier than splitting down.

One example is the use of B2B portals to capture the data at source and drop clean validated data down to NOVUS, the brokers' back office system.

For the MGA, the use of NOVUS means data is stored and sent out at the most granular level as required, with checks and balances that mean sanctions checks, policy periods, states, counties, countries and currencies are all captured at the start.

The TOM promises some big changes, but the progress is barely at a snail's pace. As I engage in NOVUS presentations and demonstrations to interested companies, I can see the market is not going to be willing to wait while deliberations move slower than Brexit!

MALCOLM SNOW is subject matter specialist at Morning Data

CALL TO ACTION

InsurTech was the market buzzword of 2017, but when it comes to using that technology to drive progress it's time to turn words into action, says **Paul Latarche**

InsurTech is set to redefine the way the insurance industry operates and the sector has seen hundreds of millions of pounds in investment over recent years.

Fears that these disruptors will change the way the market operates have blighted the thinking of the traditional markets. It is clear that the market is fearful of where it finds itself and believes it is in a precarious position.

It was with great interest that I attended *The Insurance Insider's InsiderTech* event in New York in December, as a panel member for the discussion on the relationship between InsurTech and the traditional (re)insurance model.

> We need to get the capital to where it can most effectively deliver its value, and that brings with it the need for the market to speed up and streamline its distribution channels

The conversations at the event were interesting and enlightening, and what struck me was that it was attended by many InsurTech firms which, while they have received tens of millions of dollars of investment in

Continued on page **54**

order to create a new and innovative front end, have little on the back end to support this high-tech facade.

I believe that in the year ahead InsurTech start-ups will need to move from conception to reality – and towards proving the premise on which they attracted their investment.

However, the market needs to understand the fundamentals of the changes that have to happen in the industry to drive relevance and, as we have seen in recent weeks, meet the demands of the regulators.

Connecting capital with risk

For me, the issue for the market is the need to drive greater connection between the capital and the risk. We need to get the capital to where it can most effectively deliver its value, and that brings with it the need for the market to speed up and streamline its distribution channels.

This is not to say that we are heading towards an era of disintermediation, but intermediaries are also facing a challenge that will put the way they operate under the regulatory microscope.

In the UK the Financial Conduct Authority (FCA) has said it will launch an enquiry into the wholesale insurance market. It noted that the London insurance market is one of the world's leading centres for large-scale, complex commercial and specialist risks, controlling more than £68bn in gross written premium.

The wholesale sector has also undergone what the regulator believes are "significant changes" in recent years, with brokers developing new services and business practices.

The FCA said it wants to explore how competition is currently working and whether it could work better.

Christopher Woolard, the FCA's executive director of Strategy and Competition, said that: "Given the size of the wholesale insurance sector and the type of large-scale risks it covers, the way it functions can have a wide-ranging impact on the broader economy. If businesses cannot get appropriate cover or pay more for services than they should, it can impact on their ability to operate and grow."

> The ability to deliver attractive and innovative front end systems is one thing, but we have to ensure that the systems behind that front end are able to fulfil their part of the process with the same speed and innovative approach

He added: "Brokers play an important part in the wholesale insurance sector, ensuring clients get appropriate coverage at good value. However, following significant changes in the sector, we are looking at the dynamics to ensure competition is working well."

Cutting costs

The section which will obviously concern Moore Stephens' wholesale broking clients is the issue of whether customers are paying more than they should.

The moves to modernise the London market have been predicated on the fact that it recognises that the frictional costs of doing business in the City are high.

It is clear the FCA will be asking wholesale brokers what value they bring to the transaction between capital provider and client and how they justify the costs of that value.

Clearly, technology will play a part in the reducing the market's costs, and at Moore Stephens in the past year our RuleBook system and RuleBook hub have continued to gather traction, with 25 percent of the London market now utilising the system and $10bn in premiums passing through it.

It delivers technology throughout the transactional process, speeding the responsiveness of underwriters and their ability to communicate new policy information or changes to existing policies quickly across its distribution channels. Fundamentally, it is designed to bring together insurers' intellectual and financial capital and allow them to be accessed in ever more efficient way, including these new customer experiences.

PAUL LATARCHE is head of Insurance for Moore Stephens

It highlights the fact that the impact of InsurTech has yet to be fully recognised, and while the potential benefits that many of the new start-ups are saying they will deliver is huge, the proof of much of this will be when these firms roll out the systems they have been working so hard to create.

Continued evolution

The ability to deliver attractive and innovative front end systems which will face the customer is one thing, but we have to ensure that the systems that are placed behind that front end are able to fulfil their part of the process with the same speed and innovative approach.

The market is on the cusp of significant change both in how it communicates with its customers and how the business is operated.

It is highly unlikely that insurance will see some sort of Uber "Big Bang" type of moment, when rapid and fundamental change occurs.

Instead, we will see a continued evolution from the traditional insurance approach to a new model that will have technology and the "Internet of Things" at its heart.

Many of the current headlines revolve around InsurTech launches for personal lines business, but the specialty and large commercial markets are driving change – albeit outside of the blaze of publicity that is part and parcel of building a brand recognisable to the wider public.

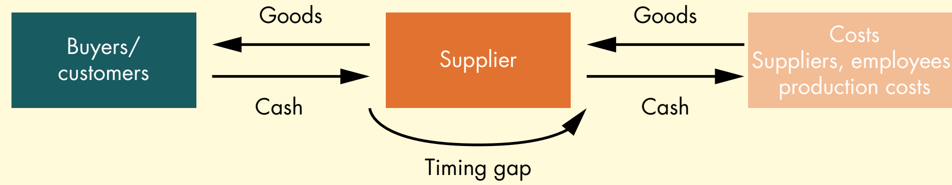
At Moore Stephens we view the year ahead as an exciting time for the industry and one in which the RuleBook system and RuleBook hub will play an increasing role in speeding response and reducing transactional costs.

FILLING THE GAP

Heneg Parthenay and **Simon Richards** look at trade finance and the opportunity for insurers to exploit the $1tn short-term funding gap of global businesses

The low-yield environment has led many insurers to expand their investment portfolios and reconsider their risk budgets in order to achieve their investment return targets. They are increasingly considering non-mainstream fixed income asset classes, which can offer higher yields than more traditional assets due to a complexity or illiquidity premium, without adding significant credit risk. One such opportunity is trade finance.

Figure 1: Many suppliers face a funding gap



Source: Insight Investment. For illustrative purposes only

What is trade finance?

Businesses often face a mismatch between when they expect to receive payments from their clients, and when they need to pay their own suppliers or spend money elsewhere (see figure 1).

Banks have traditionally bridged this gap by providing "trade finance", and continue to do so. But since the financial crisis, higher capital and liquidity requirements have led them to de-lever their balance sheets and curtail certain activities.

Estimates from the Asian Development Bank in 2015 suggested the withdrawal of banks from this space has created a potential $1tn gap between demand and supply for trade finance.

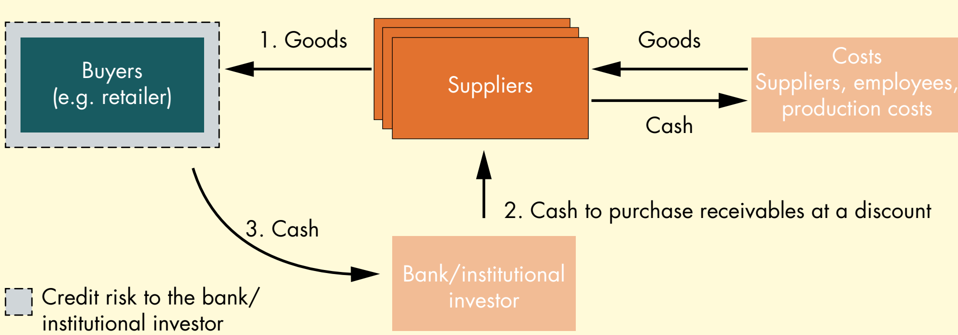
This gap creates an opportunity for institutional investors to step in and to benefit from exposures which can be tailored to meet their credit requirements.

Trade finance consists of offering funding to businesses to help them accelerate payments to suppliers or to fund working capital. It typically falls into two distinct types:

Supply chain financing – providing funding to the suppliers of a large corporate;

Receivables financing – providing funding to a supplier, secured by receivables from its customer base.

Figure 2: Supply chain financing



Source: Insight Investment. For illustrative purposes only. Numbers illustrate typical sequence of activity

Supply chain financing

Supply chain financing allows suppliers to receive payments earlier than contractually agreed with a buyer under their standard payment terms, and allows them to better manage their working capital requirements (see figure 2).

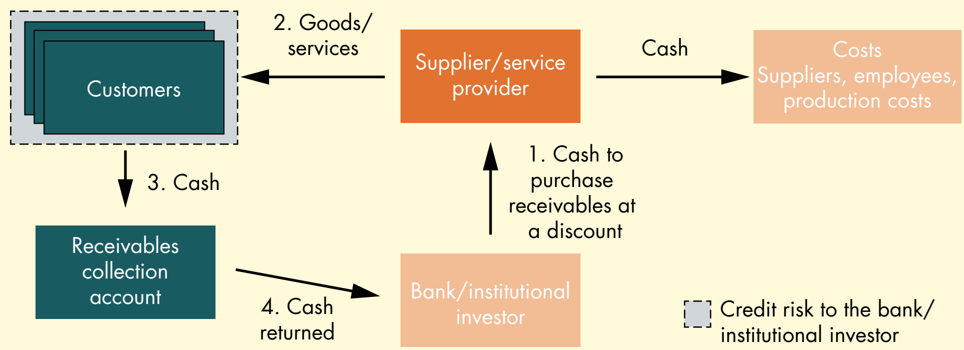
The credit risk for the finance provider is to the end buyer, rather than the suppliers. The end buyer is typically a large corporate with a credit rating issued by an external credit assessment institution.

Even if the suppliers do not have the same access to financing as the end buyer, because supply chain finance is provided on the basis of the end buyer's credit rating, the suppliers could receive cheaper financing as a result. This provides another incentive for suppliers to seek out this particular method of trade finance.

For the same credit risk, a finance provider can typically achieve a higher yield through providing supply chain finance than if it provided finance direct to the end buyer through, for example, the bond market.

In order to implement the process efficiently, technology can play a major role with an efficient electronic platform for the buyer to record invoices, to assess whether they meet the agreed specification for payment, and to submit them to the finance provider (in this case the insurer) for payment.

Figure 3: Receivables financing



Source: Insight Investment. For illustrative purposes only. Numbers illustrate typical sequence of activity

Receivables financing

Receivables financing allows companies to receive early payment on a pool of their customer invoices (see figure 3).

Investor exposure is to the underlying customer base, which is typically well diversified. The investor would have the ability to define upfront the criteria that would apply to the receivable to make it eligible to be part of the facility.

Revolving financing facilities for trade receivables typically have quality and concentration limits and dynamic triggers to provide incremental credit enhancement, which may include additional protections to shield investors in times of stress or seller/servicer risk.

Potential benefits for insurers

Trade finance can offer the potential for attractive yields with relatively short-maturity (30-180 days) underlying credit exposure. The investor typically needs to commit to providing a facility for a minimum period, e.g. one to four years, even though the term of the underlying assets is much shorter.

However, the agreement would normally incorporate early termination triggers covering the performance of the underlying pool of receivables, the supplier's insolvency, change of control, and so on).

Historical losses in short-term trade finance portfolios have been very low (Source: ICC Trade Register Report 2016), and returns typically have low correlation to other financial assets.

These characteristics mean that trade finance is potentially more attractive than short-dated government and corporate bonds, which currently offer yields at close to or below zero in some developed economies.

HENEG PARTHENAY is head of Insurance at Insight Investment

SIMON RICHARDS is head of Insurance Solutions at Insight Investment

Managing the risks

As with other forms of private secured credit, to exploit the complexity and illiquidity premiums on offer, access to extensive expertise – beyond that needed for traditional fixed income investments – is necessary.

Specialists can help institutional investors to consider key issues around trade finance, including the following:

- How to structure the exposure to achieve the most appropriate regulatory treatment;
- How to negotiate financing terms and structural protections;
- The appropriate currency of the permitted assets and how currency hedging is achieved;
- The time horizon of the investment and the maximum maturity of any individual loans;
- The targeted average credit quality of the portfolio and restrictions on individual loans;
- The targeted yield and what this means for credit risk;
- The need to agree appropriate concentration limits by issuer, sector and geography.

We believe that an appropriately structured investment in trade finance can achieve attractive risk-adjusted returns for insurers, while achieving an efficient capital treatment.

> Estimates from the Asian Development Bank in 2015 suggested the withdrawal of banks from [providing trade finance] has created a potential $1tn gap between demand and supply

READY, STEADY…WAIT?

Calls to delay implementation of the Insurance Distribution Directive reflect the market's concern about its readiness for such a fundamental change, say **Jonathan Charwat** and **Robbie Constance**

Up until fairly recently, it was settled that the Insurance Distribution Directive (IDD) would be implemented throughout Europe on 23 February 2018. It now seems likely that, due to the significance of the changes and a combination of the market and regulators not being prepared, the application of the IDD will be delayed until later next year.

Prior to calls for a delay, in the UK at least, the IDD had been positioned as an evolution of the rules rather than a revolution. In its consultation papers, the UK Financial Conduct Authority (FCA) repeatedly stated that a good deal of the changes should not have too significant an impact, as firms are expected to already be compliant with existing FCA rules, principles and guidance (such as the Responsibilities of Providers and Distributors for the Fair Treatment of Customers).

Our view is that the IDD, together with wider regulatory changes over the next year – most notably under the Senior Managers and Certification Regime (SM&CR) – will represent significant change for those involved in the distribution of insurance (including insurers and wholesale intermediaries).

There are clearly going to be practical and systems changes required (for example, in product governance and development, and customer communications) but there will also be potentially fundamental changes to the market in terms of business models, competition and culture.

Where are we now?

Over the past few weeks there have been calls, most notably from Europe but echoed and supported here in the UK (by, for example, the Managing General Agents' Association and the Association of British Insurers), to delay the application of the IDD.

It now seems likely that the IDD will apply to firms in October 2018 – which is the recommendation of the EU Parliament's Economic and Monetary Affairs Committee, but is still awaiting approval from the European Commission.

Here in the UK, support for the delay appears to stem from two views held by market participants. Firstly, that the rules are not sufficiently final and that there is not sufficient guidance and, secondly, that firms would not have enough time to properly prepare anyway – particularly as the FCA still needs to release its final rules on two of its consultation papers (which are expected to be issued in December and January).

Wider regulatory change

It is important to consider the impact of the IDD against other regulatory change projects that are going to be required over the next 18 months – most notably the SM&CR and also the General Data Protection Regulations.

SM&CR will introduce more individual accountability for compliance with regulatory rules than ever before in the insurance market, while the IDD is (at least) a codification of existing principles into rules with which firms and senior managers will need to demonstrate compliance.

All of these changes coincide with the culmination of the FCA's thematic reviews into the general insurance market, the launch of further reviews into pricing and "value in the distribution chain" and the recently announced market study into wholesale brokers. Next year will be a busy one for regulation of the insurance market.

The changes

The IDD's purpose is to improve customer protection and ensure that all customers enjoy these protections regardless of the distribution method.

These protections start right from the beginning when a product is being designed and continue through the customer journey, covering the on-going targeted distribution strategy and ensuring that employees involved in the journey are competent and understand the product.

Interactions with the customer will be more heavily prescribed by rules aimed at improving a customer's understanding of the insurance product and should ensure that the customer has all the information they need on the firm selling the insurance product and its relationships (financial and otherwise) with other firms in the distribution chain.

To meet its objectives, a major tenet of the directive is a new rule requiring all firms in the distribution chain to act honestly, fairly and professionally in accordance with the customers' best interests. This rule is clearly intended

> "The IDD, viewed together with wider regulatory changes over the next year, will represent significant change for those involved in the distribution of insurance"

to go beyond the existing "treating customers fairly" principle, which only obliges firms to pay due regard to a customer's interests.

The impact

The impact of this rule will be greater on some firms than others. Brokers acting as agents of the insureds already have a duty to act in their clients' best interests but wholesale brokers and insurers (not traditionally in contact with the customer at the outset) will need to consider this rule more carefully – including balancing it against any duties (such as a coverholder's duty to its own principal).

The customers' best interests rule pervades the other IDD rules on remuneration, product governance and on what information is to be provided to customers and when. On remuneration, brokers and insurers selling direct to customers must not be paid, or pay or assess their employees' performance in a way that conflicts with the customers' best interests rule.

As a result firms may need to reconsider their current variable pay and sales practices and broker remuneration arrangements.

The regime around communications with customers will look quite different. Firms not only need to consider revised rules on what information should be provided to customers on the insurance products and about the firms in the distribution chain, but also when and how it should be provided – and always with the customers' best interests rule in mind.

Firms in contact with the customer will be required to disclose information on their role and their relationship with other firms in the distribution chain, including how they are remunerated.

For example, a broker may need to disclose that it receives commission from an insurer which is calculated on the total premium, and an insurer may need to disclose that its employees receive bonuses based on the number of policies sold.

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Practical changes

These changes will result in practical changes to systems and processes – for example, telesales will now include new content and take longer, which will incur a cost (which the FCA estimates at between £5,000 and £560,000 for remuneration disclosures).

However, this does not factor in the costs of potential customers not purchasing insurance products as a result of the new information they receive. How customers respond to this new information could have a significant impact on business models in the distribution chain.

All consumers (and some commercial customers) will need to be provided with a standardised summary document called the Insurance Product Information Document (IPID). The aim of the IPID is to provide the customer a snapshot of the insurance product to compare against other products.

What the IPID should look like (length and formatting) and the information it should contain is highly prescribed in the rules. That said, a major challenge for firms will be to determine the right level of detail in each section, particularly when dealing with complex insurance products. As a result of the IDD's full product lifecycle and customer journey approach to insurance product distribution, changes are clearly going to be felt throughout the distribution chain and firms will need to consider how best to demonstrate compliance with the new regime in a way that fits in with their business model whilst bearing in mind the approach that their competitors are taking.

WINNING PERFORMANCE

With a lack of objective data for sizing up relationships with their US legal counsel, London market clients are left with a subjective approach to measuring quality of service, says **Dwayne Hermes**

To paraphrase the founders of legal services firm Axiom Global, the relationship between clients and the legal industry is a broken marketplace. Even more troubling, this is a marketplace without any insight into the extent to which it is broken.

In 2017, in my role as a US attorney serving the Lloyd's market, I met 26 managing agents, and when the conversation in these meetings turned to the topic of measuring the performance of their attorneys in the States, all but one acknowledged that there was no objective measure being applied.

The general sentiment was: "I have a good personal relationship with my attorneys and they have kept me out of trouble."

With further inquiry into key performance indicators (KPIs) for attorney performance – for example, average legal fees per file, budget accuracy, evaluation accuracy and average case life – the same general response was forthcoming.

Mostly, all of those with whom I spoke acknowledged the benefit of having such "data" (the magic word of the day, especially when coupled with "analytics") and lamented the reality that it was currently not available to them. To their credit, one of the 26 was beginning to take steps to capture this data.

But would this lack of insight into the quality of a service be accepted by any of us in any other setting?

Subjective approach

With the lack of objective data upon which to measure the relationship with attorneys in the States, the market is left with a subjective approach to measuring quality. Thus, a counsel selection process exists that is often based upon friendships, social interactions and a general perception of value.

For example, in Texas, where I practice, it can be socialising at the gun range that supports the relationship.

If this is the state of affairs, is there actually any measurement of quality at all? When one considers the amount of money that changes hands within these relationships, can there be a valid argument that the "store is being properly tended to"?

If there is no measure of quality that has a basis in objective fact, how can there be a foundation on which to pursue improvement? How can one service provider be compared to another? How can the buyer know when it is time to make a change? Is counsel selection determined solely based on price, with little to no accurate consideration of value?

The intent of this commentary is not to chastise those who are selecting counsel without objective insights. With the void created by the lack of data, what are claims professionals left to turn to other than subjective relationships? Even if they wanted to base the buying decision on objective data, due to the structural and reporting realities of the market, the necessary information is not available to them, or at least is very difficult to mine.

In a time when all industries, all professionals and all commercial endeavours are expected to be "better, faster, cheaper" (see "Tomorrow's Lawyers", by Richard Susskind, Oxford University Press, 2013; "Living Through a Paradigm Shift," by William D Henderson, NALP Bulletin August 2014; and "The Last Mile: The 'Last Mile' Problem and the 'Last Mile' Solution," by William D Henderson, Legal Evolution, 26 May 2017, originally published on Law.com) how can this sophisticated market justify the inability, due to the lack of data, to apply these principles to the retention of legal experts?

The current state of affairs allows for, and even promotes, unhealthy professional and commercial relationships that lack transparency and accountability and therefore allow for complacency and stagnation.

It impedes any hope of continual process improvement and innovation. We know that "what gets measured gets done", so the lack of measurement results in a lack of alignment around KPIs. The fact that there is no return on investment measure for legal experts further exacerbates the problem.

Tomorrow's lawyers

So, what is my professional background upon which I rely to raise these questions?

By outside appearance, I am a typical insurance defence attorney like all the others regularly seen in the market. I have been practicing law for over 30 years in Texas, one of the most litigious states in the US. During my career, I have been responsible for originating over

> "The current state of affairs allows for, and even promotes, unhealthy professional and commercial relationships that lack transparency and accountability and therefore allow for complacency and stagnation"

$75mn in legal fees.

After 15 years of practicing with one of the best defence firms in Texas, I embarked on the path of starting my own firm. That firm became the 45th largest in Texas, with over 50 attorneys, over 100 employees and hundreds of client relationships, and was well received by the insurance industry. It had a successful run for 15 years.

Two-and-a-half years ago, I participated in the voluntary dissolution of that firm and started what we believe is, or is in the process of becoming, the first working model of the Richard Susskind-type law firm envisioned in "Tomorrow's Lawyers" (a statement made by some in the academic community).

This current business vehicle is where the atypical nature of my professional leaning has become more public. The goal of myself and of my colleagues in this "next generation law firm" is to disrupt the way in which law firms in the United States operate and how legal services are measured and delivered.

A full embrace of legal metrics, analytics and value-based compensation is at our core. In the continuum of legal services identified by Richard Susskind, we are moving from "bespoke" to "systematised" through the use of process management, checklists, technology, knowledge management and workflow.

My belief is that what we are doing should be the standard fare that the market expects from its attorneys in the States. By instituting this standard, the market will have law firm partners (pun intended) that are collecting and reporting on the relevant data and, in turn, the market will be able to properly select and oversee its counsel.

This benefit, in and of itself, is an adequate basis to merit this change. An additional, and potentially just as impactful, outcome will be the opportunity for the market to enter into a relationship of continuous process improvement. The continual process improvement will be rocket-fuelled by a move to "value-based compensation" – but that is a topic for another day.

The path ahead

You may ask, now that I have stated my opinion on the state of affairs between the market and the providers of legal services in the States, what is the path to a better-performing relationship?

The answer is an agreed-upon set of measures. To this end, the Lloyd's Market Association has initiated a project to improve data on, and support the oversight of, experts. My firm is working with the Lloyd's Market Association, Professor William Henderson of the Indiana University Maurer School of Law and other interested professionals in the market, through a working group focused on performance-based measures, management information, analytics and intelligence, in order to identify the opportunities to enhance the legal service provider model via technology and data.

With these key measures, the next step will be capturing data from actual performance and benchmarking against these measures. With that data, relationships will need to be reviewed and monitored.

Within a professional relationship, friendship and objective measurements of quality are not mutually exclusive, and they are not necessarily inclusive. Where deficiencies are identified, efforts will need to be undertaken to obtain better performance or to identify new providers.

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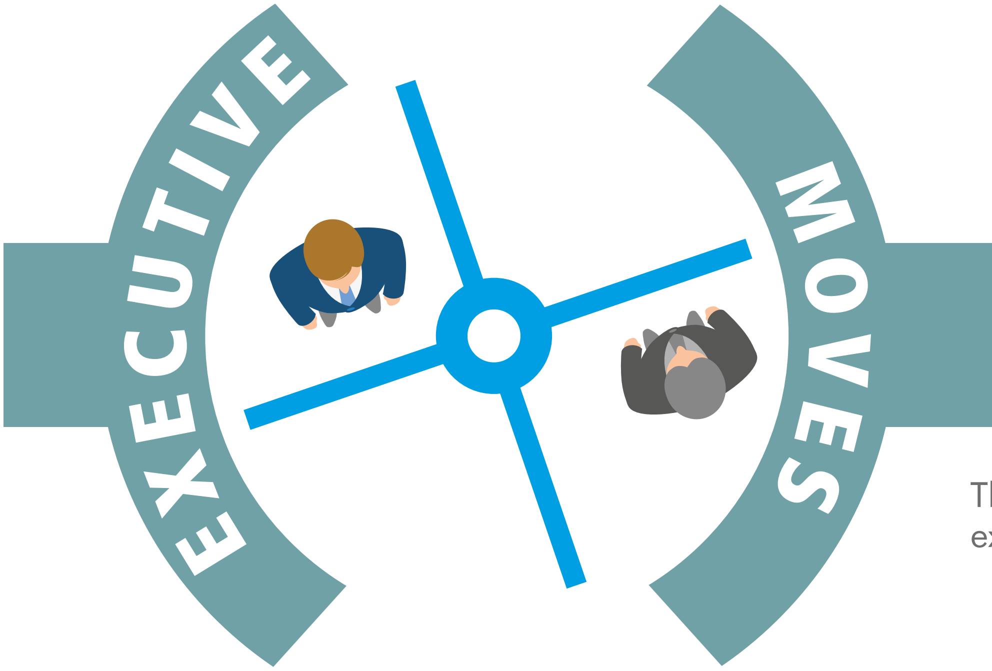

The Ins and Outs of the executive job market

Julian Samengo-Turner

Julian Samengo-Turner, whose return to the facultative market at Willis Towers Watson was revealed in September, is to head emerging markets facultative business at the broker, covering Central and Eastern Europe, the Middle East, Africa, Asia and Australasia. Samengo-Turner was formerly co-head of Integro's international division, alongside Ron Whyte.

Thomas Götting

XL Catlin's insurance operation has appointed Thomas Götting as country manager for Germany with effect from 1 January. He replaces Dieter Goebbels, who is retiring. Götting joins from credit insurer Coface, where he was a regional commercial director.

Torsten Leue

Talanx has appointed Torsten Leue as its new CEO, while current leader Herbert Haas will move to its supervisory board. Leue was previously CEO of Talanx International, and was a member of the group management board responsible for international retail business.

John Berger

Ascot has hired John Berger to lead its new Bermuda reinsurance division. He will join Ascot Re in January, pending immigration approval. Rival carrier Third Point Re announced Berger is to step down as its chairman in December. Berger stepped down as Third Point Re CEO in March, to be replaced by Rob Bredahl.

Pina Albo

Hamilton Insurance Group has hired Giuseppina "Pina" Albo from Munich Re as its new CEO, with effect from 1 February. She succeeds David Brown, who was named interim CEO after the departure of Brian Duperreault in May. Albo's responsibilities at Munich Re included the P&C business and operations in Europe and Latin America.

Charles Philipps

MS Amlin CEO Charles Philipps is preparing to retire from the Lloyd's (re)insurer. The exact timing of his retirement will depend upon the appointment of his successor, with the executive set to remain in place until the search is complete. However, a departure in late Q1 or early Q2 2018 is said to be likely.

Joe Zubrestsky

The Hanover's president and CEO Joe Zubretsky has left the company less than 18 months after he took up the roles in June last year. The executive has moved to Medicaid and Medicare provider Molina Healthcare as CEO.

John "Jack" Roche, formerly head of the company's personal and commercial lines businesses as president of Hanover Agency Markets, was named as Zubretsky's replacement.

Jeremy Brazil

Jeremy Brazil is planning to stand down as underwriting director of Markel International at the end of this year. Brazil played a major role in the creation of Markel International following Markel's acquisition of Terra Nova in 2000. He will continue to offer consultancy advice to the board and senior management team.

John Neal

Australian carrier QBE said CEO John Neal will step down at the end of this year after five years in the role. He will be replaced by Pat Regan, who is currently CEO of the group's Australian and New Zealand operations and was, until September this year, interim chief financial officer at QBE.


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